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In the

Supreme Court of the United States

October Term, 1973

No. 73-718

BANGOR PUNTA OPERATIONS, INC. and
BANGOR PUNTA CORPORATION,
Petitioners,

v.

BANGOR & AROOSTOOK RAILROAD COMPANY and
BANGOR INVESTMENT COMPANY,
Respondents.

On Writ of Certiorari to the United States
Court of Appeals for the First Circuit

BRIEF FOR THE RESPONDENTS

QUESTIONS PRESENTED

1. May the Railroad sue in its own name and behalf to recover damages for assets which its former majority stockholder divested from it in violation of federal and state law?
2. Have the Railroad and its subsidiary standing to sue where they have been injured by acts of the Petitioners that constitute (i) conversion at common law (ii) violations of the Clayton Act and (iii) violations of SEC Rule 10b-5?

3. Is the Railroad to be denied a remedy because its present majority stockholder may enjoy a benefit therefrom?

STATUTES AND REGULATIONS INVOLVED

In addition to the statutes and regulations mentioned in the Petitioners' brief, there are involved Section 4 of the Clayton Act, 15 U.S.C. § 15; Section 2072 of the Judiciary Code, 28 U.S.C. § 2072; Sections 5(2) and 13a of the Interstate Commerce Act, 49 U.S.C. §§ 5(2) and 13a; and Section 15 of the Maine Public Utilities Act, 35 M.R.S.A. § 15.

The text of these statutes is set out in Appendix A to this brief.

STATEMENT OF THE CASE

This action is brought by the Bangor and Aroostook Railroad Company (Railroad) and its wholly-owned subsidiary, Bangor Investment Company (BIC), against Bangor Punta Corporation (BP) and its wholly-owned sudsidiary, Bangor Punta Operations (BPO). The Railroad is a Maine corporation organized in 1891. (A.1-2) It provides essential services for those persons and businesses located in the northern half of Maine. (A.2) Its Comparative General Balance Sheet as contained in the Railroad Annual Report, Form A, for the year ending December 31, 1972, as filed with the Interstate Commerce Commission, shows assets of $67,726,890.

This suit was authorized by vote of the Railroad's Board of Directors. (A.46-7) In July of 1971 (A.6) there had been made public a Report[1] (ICC Report) to the Interstate Com-

[1] The Report is set out in Appendix B to this brief. Judicial notice may be taken of it. *Arizona* v. *California*, 283 U.S. 423, 454 (1931). See the order of the court of appeals. (A.53)

merce Commission (Commission) prepared by the Bureau of Accounts of the Commission, entitled "Review of Diversified Holding Company Relationships and Transactions of Bangor Punta Corporation." The ICC Report stated:

> "The purpose of the review was to explore the impact of the Bangor Punta Corporation on the Bangor and Aroostook Railroad while it was owned by and under the control of this diversified holding company and to determine whether or not the intercompany relationships and resulting financial transactions were detrimental to the carrier." (p. 45, *infra*)

The ICC Report included a recommendation:

> "We recommend that all legal remedies be explored to require the holding company, which sold the carrier, to pay back to the carrier for assets taken with no compensation and charges made where no services were performed." (p. 46, *infra*)

The ICC Report was discussed at a meeting of the Railroad's Board held on July 29, 1971. (A.44-5) Since some of the directors were not then familiar with it, no formal action was taken. On August 26, 1971, copies were mailed to all directors. (A.45) At a meeting held December 8, 1971, the Railroad's outside counsel discussed, "paragraph by paragraph", a draft complaint explaining the legal basis of the various claims contained therein. (A.46) It was unanimously voted to authorize the Railroad's Chief Executive Officer, upon advice of counsel, to commence and conduct litigation. (A.46-7)

The Claims Asserted

The original complaint was filed in the U. S. District Court for the District of Maine on December 30, 1971, (A.ii)

and an amended complaint was filed on August 18, 1972. (A.iii) It is alleged,

> "The causes of action asserted in this Amended Complaint belong to [the Railroad] and are asserted directly by it." (A.5)

Both complaints contained thirteen counts asserting violations of Section 10(b) of the Securities Exchange Act, 15 U.S.C. § 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. § 240.10b-5; Section 10 of the Clayton Act, 15 U.S.C. § 20; Section 104 of the Maine Public Utilities Act, 35 M.R.S.A. § 104; and the Maine common law. As examples, the facts underlying one count under each theory are set out here.

1) Rule 10b-5

Count VI (A.14-5) alleges that in September 1962 BIC owned 67,789 shares of stock in the St. Croix Paper Company, worth in excess of $2,000,000. The Bangor and Aroostook Corporation (BAC), the predecessor holding company of BP and BPO (A.4), learned from inside sources that the Georgia Pacific Corporation was negotiating with St. Croix to make a tender offer to St. Croix stockholders. Before this information became public and without disclosing it to either the Railroad or BIC, BAC caused the Railroad and BIC to enter into a three-way agreement whereby all 67,789 shares of St. Croix stock were transferred to BAC. As a result, the Railroad and BIC suffered damages of approximately $1,500,000, which is the profit that BAC made on the exchange of St. Croix stock for Georgia Pacific stock, which occurred shortly thereafter, and the subsequent appreciation of Georgia Pacific stock.

2) Section 10 of the Clayton Act

Count IV (A.13) alleges that in September 1962 BAR and BAC had nine overlapping directors. As part of the three-

way transaction involving the St. Croix stock, described above, some $1,018,000 par value of BAC preferred stock was transferred to the Railroad at its par value of $100 per share, without satisfying the bidding requirements of Section 10 of the Clayton Act. The fair market value of the preferred stock was substantially less than the par and than the fair market value of the St. Croix stock.

3) Maine Public Utilities Laws: 35 M.R.S.A. § 104

Count II (A.9-10) alleges that from 1962 through 1967 first BAC and then its successor BPO, while owning in excess of 97% of the Railroad's voting stock, billed the Railroad for "corporate charges" and received payments aggregating $810,000. None of these contracts, arrangements or payments for alleged legal, accounting and printing services was submitted to the Maine Public Utilities Commission for approval as required by Section 104, and, in fact, these arrangements were adverse to the public interest and would have been disapproved if submitted, because virtually none of these services was performed for the Railroad.[2] (A.8-9)

4) Maine Common Law: Conversion

Count I (A.8-9) alleges that $810,000 was paid to BAC and BPO for nothing but nominal services and was authorized by officers and directors who at the time were also officers and directors of BAC or BPO, had conflicting loyalties and placed the interests and welfare of BAC and BPO ahead of the Railroad. These payments amount to conversion and misappropriation of assets.

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[2] Under Maine law railroads are public utilities. 35 M.R.S.A. § 15, set out in Appendix A to this brief. Section 104 is set out in the Petitioners' Brief at A-7.

Further Facts

Approximately 99% of the Railroad's stock is now owned by the Amoskeag Company (Amoskeag), a diversified operating company, registered under the Securities Exchange Act of 1934, with its stock publicly held and traded.[3] Amoskeag purchased in excess of 98% of the Railroad's stock from BP and BPO on October 2, 1969 and has acquired another 1% in miscellaneous small transactions since that time. It is alleged that the domination and control of the Railroad by BP, BPO and their predecessor, BAC, "resulted in fraudulent concealment of the systematic exploitation of [the Railroad] and, further, prevented any effective investigation being made of such exploitation and the commencement of any suit with respect thereto until after [the Railroad] was sold in 1969". (A.5)

In addition to Amoskeag, there are presently twenty-two stockholders in the Railroad. (A.6-7, 22-3) Twelve of these acquired their stock prior to 1960. (A.6-7, 22-3) The Railroad's debt obligations, at the time of the Amended Complaint, consisted of almost $6.9 million principal amount of First Mortgage Bonds, $2.7 million of Income Promissory Notes and $14.5 million of equipment obligations. (A.7)

All the events upon which the thirteen counts in the Amended Complaint are based occurred between 1960 and 1967. (A.8-20)

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[3] Amoskeag formerly was an investment company registered under Section 8 of the Investment Company Act of 1940, 15 U.S.C. § 80a-8, but this registration ceased by S.E.C. order effective November 3, 1972.

SUMMARY OF ARGUMENT

I

The Railroad is a Maine public utility corporation organized "for the purpose of . . . operating a railroad for public use". The Amended Complaint alleges that the causes of action asserted belong to the Railroad and are asserted directly by it. There is no evidence in the record indicating otherwise. The separate identity of the Railroad should not be disregarded solely because the Railroad has a majority stockholder.

The public interest involved requires that the Railroad be recognized as a separate entity. Numerous Supreme Court cases recognize the public interest in the proper management of railroads. It has been frequently asserted that railroads are "public highways". The Transportation Acts of 1920 and 1940 and the Regional Rail Reorganization Act of 1973 recognize the public interest in railroads. Mergers involving railroads are regulated in the public interest under Section 5(2) of the Interstate Commerce Act. Railroad reorganizations are effectuated under a special part of the Bankruptcy Act, Section 77, which assures that the public interest will be considered. In Maine, also, there are numerous cases recognizing the distinctive status of railroads, and railroads in Maine have the power of eminent domain. The line of cases, upon which BP and BPO rely to bar this suit by the Railroad, involve ordinary private business corporations.

Also, the *Home Fire* case itself, while dismissing counts brought in equity, allowed the plaintiff to recover on counts at law. All of the counts brought by the Railroad are at law, not in equity. Therefore, the court of appeals correctly

distinguished *Home Fire* in holding that the Railroad could maintain this action.

II

The Railroad has standing to bring this action, because it has suffered direct injuries as a result of BP and BPO's illegal actions. The common law counts are based on simple conversion. It is alleged that BP and BPO took assets of the Railroad illegally and without giving adequate consideration. The Railroad has standing under Section 4 of the Clayton Act, because it has alleged that it was injured in its business or property by acts of BP and BPO that violated Section 10 of the Clayton Act. The Railroad has standing under SEC Rule 10b-5, because it is alleged that the Railroad was involved in the purchase and sale of securities with BP and BPO, because BP and BPO used fraudulent and deceptive practices in connection with the securities transactions, and because the Railroad was injured as a result.

III

Rule 23.1, F.R.Civ.P., does not apply to this case, because the action is brought by the Railroad and not by a stockholder on behalf of the Railroad. In a derivative case the plaintiff-stockholder is required to allege that he made demand on the corporation to bring the action and that the Board refused. But here the Board voted to have the Railroad bring the suit. The purposes behind Rule 23.1 do not apply here. There has been no transfer in anticipation of suit to create federal jurisdiction. This is not a strike suit by a minority stockholder.

In addition BP and BPO are trying to use Rule 23.1 as a basis for an affirmative defense. This is an impermissible use of the rule, because it would abridge or modify the

substantive rights of the Railroad. Rule 23.1 may be used only to determine whether a particular plaintiff-stockholder has standing to assert a cause of action belonging to his corporation.

IV

Any recovery here will not be available to Amoskeag as a windfall, because the district court has the power to frame a decree limiting the use of the funds recovered to such purposes as upgrading of track and roadbed or purchase of equipment. Thus, the public would receive the direct and immediate benefit of improved transportation services.

ARGUMENT

I. THE COURT OF APPEALS CORRECTLY HELD THAT A RAILROAD MAY SUE IN ITS OWN NAME AND BEHALF TO RECOVER ASSETS WHICH ITS FORMER MAJORITY STOCKHOLDER DIVESTED FROM IT IN VIOLATION OF FEDERAL AND STATE LAW

This action at law was commenced by the Railroad, a Maine public utility, to recover damages for assets of which it was divested by action of its former controlling stockholder. It was brought in response to the ICC Report which had concluded that, although the depredations committed by the former majority stockholder were completely reprehensible and ought to be punished, under existing law and regulations there was nothing the Commission could do about it.[4] The Railroad itself thus undertook to right the wrong.

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[4] See pp. 53-55 *infra*. These parts of the ICC Report make specific recommendations regarding future Commission action to control these practices.

The district court dismissed the entire complaint, treating it as a typical shareholder's derivative suit barred by the contemporaneous ownership rule, Rule 23.1, F.R.Civ.P., and by equitable principles. To reach that conclusion, the court had to find, contrary to the pleadings, that the action was brought by the present majority stockholder and not by the Railroad.

The court of appeals reversed. It held that the Railroad should be permitted to maintain its action; indeed it had a duty to do so. (A.61) Protection of the public interest in the Railroad's ability to survive and provide services far outweighed any windfall which the present majority stockholder, not a wrongdoer, might receive.

We submit that the decision of the court of appeals is correct and should be affirmed. The Railroad has been injured; its right of recovery ought not to be cut off because the wrongdoer managed to sell its stock before the wrong was uncovered.

A. This Action Is Brought By The Railroad And Not By Its Present Majority Stockholder

The Amended Complaint is brought by the Railroad (and its wholly-owned subsidiary), a Maine corporation organized "for the purpose of constructing, maintaining and operating a railroad *for public use*". (A.1-2) (emphasis added) It was filed with the unanimous vote of the Railroad's Board of Directors after the Board, with special counsel, had reviewed the Complaint "paragraph by paragraph". (A.45-7) It should be noted that at the time the Railroad's Board of Directors authorized the litigation, twelve of its seventeen members had been directors during the old regime, that is, before the present majority stock-

holder, Amoskeag, purchased its shares in October 1969. (A.44) Of the ten directors voting to authorize the suit, a majority, six, had been serving prior to 1969.

In other words, the record is quite clear that Amoskeag did not change the Railroad's Board after it purchased its stock and then cause the new Board to bring the action. The Board which authorized commencement of the litigation was controlled by directors who had served while BP and BPO owned and controlled the Railroad, and who continued to serve after it was sold to Amoskeag.

BP and BPO refuse to accept the fact that this is the Railroad's action. An analysis of their Brief discloses that the success of their argument depends entirely upon convincing this Court, contrary to fact[5], that this is Amoskeag's suit. Thus, BP and BPO argue:

> It is clear, however, that even if the public right assumed by the First Circuit did exist, Amoskeag would not have standing to assert it. . . The starting point of any consideration of standing in the instant case is the undisputed fact that the real plaintiff and party in interest suffered no injury as a result of the acts upon which the suit is brought." (Petitioners' Brief, Pg. 7)

For purposes of this case, at least, BP and BPO deny the separate identities of the Railroad and its majority stockholder. This is clearly contrary to the law of Maine and the decisions of this Court.

In *Ulmer* v. *Lime Rock Railroad Company,* 98 Me. 579,

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[5] BP and BPO filed with their motion for summary judgment no affidavits or other evidentiary material to contradict the allegations that "The causes of action asserted in this Amended Complaint belong to [the Railroad] and are asserted directly by it" (A.5). The Houston affidavit, filed by the Railroad (A.43-7), supports these allegations.

57A.1001 (1904), the Supreme Judicial Court, in rejecting the argument that, since all of the stock of the railroad (except for director qualifying shares) was owned by a private corporation, the railroad was being used for a private rather than public purpose and hence should not exercise the power of eminent domain, observed at 594, and at 1006:

> "Whoever may be the owner of the stock of the railroad company, or however many or few such owners there may be, that corporation still continues to exist as a separate and independent corporation; it preserves its corporate existence, it operates its own road, it has its own officers and makes its own contracts. . . Neither do the stockholders of a corporation control the property of the corporation . . . [T]he control of the property of the corporation is in the corporation itself and in its officers and agents. . ."

See also *Wells* v. *Dane,* 101 Me. 67, 63A.324 (1905) where the court insisted the corporation rather than its majority stockholder bring the action at law against the wrongdoer since the wrong was primarily against the corporation.

In *Pullman's Palace Car Co.* v. *Missouri Pacific,* 115 U.S. 587 (1885) this Court found that, although the Missouri Pacific owned enough of the stock of the St. Louis, Iron Mountain and Southern to control election of its directors, "the directors now control the road through their own agents and executive officers, and these agents and officers are in no way under the direction of the Missouri Pacific Company." *Id* at 597. Accordingly, this Court refused, in equity, to enforce a contract against the St. Louis, Iron Mountain and Southern on the theory that Pullman had the same contract with Missouri Pacific. [See also, *Home Telephone Company* v. *Darley,* 355 F.Supp. 992, 998 (N.D. Miss. 1973), where the court held that the separate identity of a corporation cannot be disregarded just because all of its

common stock is owned by another corporation.]

We submit that no tenable argument can be made on the basis of the record before this Court, either at law or in equity, that the present action is Amoskeag's and not the Railroad's.

B. The Public Interest In The Affairs Of Railroads, Well-Recognized In Both Federal And State Law, Makes This Action Mandatory

The court of appeals determined that the Railroad "should be permitted, and indeed *has a duty,* to recover for itself any assets which were divested from it in violation of state or federal law". (A.61) (emphasis added) The opinion makes clear that the duty is derived from the high degree of the public interest "unlike the private interest of stockholder or creditor" in the ability of a railroad to provide services "and, indeed to survive". (A.60)

The public interest in railroads has elicited a wealth of strong judicial and legislative statements in support thereof.

Supreme Court Cases

In *Barton* v. *Barbour,* 104 U.S. 126 (1881), a tort action against a railroad receiver, this Court stated at 135:

> "A railroad is authorized to be constructed more for the public good to be subserved, than for private gain. As a highway for public transportation, it is a matter of public concern, and its construction and management belong primarily to the Commonwealth, and are only put into private hands to subserve the public convenience and economy. But the public retain rights of vast consequences in the road and its appendages. . ."

Public interest in the management and operation of a railroad was also declared by this Court in *Union Trust Co. of New York* v. *Illinois Midland Ry. Co.*, 117 U.S. 434, 455-6 (1886).

As to the relative priority of a railroad's stockholders vis-à-vis the public, this Court declared in *Woodstock Iron Company* v. *Richmond and D. Extension Co.*, 129 U.S. 643, 656-7 (1889):

> "All arrangements . . . by which directors or stockholders or other persons may acquire gain, by inducing those [railroad] corporations to disregard their duties to the public, are illegal and lead to unfair dealing, and thus going against public policy will not be enforced by the Courts".

See also *Commissioners of Buncombe County* v. *Tommey*, 115 U.S. 122, 128-9 (1885), *U.S.* v. *Trans-Missouri Freight Association*, 166 U.S. 290, 321-2, 332-3 (1897), *Eckington & S.H.R.* v. *McDevitt*, 191 U.S. 103, 114 (1903), and *Charlotte C. & A.R.* v. *Gibbes*, 142 U.S. 386, 393 (1892)

Most of the more recent decisions of this Court involving the public interest and railroads have focused on mergers under Section 5(2) of the Interstate Commerce Act.[6] The Transportation Act of 1940 amended this section in such a way as to give explicit statutory recognition to the public interest. Thus, the Commission under Section 5(2) must consider the effect of the proposed transaction "upon adequate transportation service to the public" and "the effect upon the public interest of the inclusion, or failure to include, other railroads in the territory involved in the proposed transaction". The concern of this Court in the more recent merger cases with the financial health of the

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[6] 49 U.S.C. § 5(2) The text appears in Appendix A to this brief.

affected railroads is well documented in its decisions.[7] In the recent *New Haven Inclusion Cases*, 399 U.S. 392 (1970), this Court found that the public interest in railcarriers is paramount to the financial interest of the carrier's bondholders. *Id* at 491-2.

Maine Cases

The court of appeals pointed out that Maine railroads are regulated public utilities under 35 M.R.S.A. §15. The concept of railroads as public highways is also recognized in Maine law.

> "That the ordinary purposes for which railroads are constructed and operated, the transportation of freight or passengers, are essentially public in their nature and of great public convenience and utility is, of course, conceded. 'They are public highways; great thoroughfares of public travel and convenience'. *In re Railroad Commissioners*, 83 Maine, 273." *Ulmer* v. *Lime Rock Railroad Company*, 98 Me. 579, 585, 57A.1001, 1003 (1904)

See also *Spofford* v. *B & B Railroad*, 66 Me. 26 (1876)

Maine railroad charters are contracts made by the legislature in behalf of the public.[8] They are "preeminent" among private instrumentalities affected with a public interest.[9] In reaching its conclusion in the instant case the court of appeals also cited the relatively recent case of

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[7] E.g. *Baltimore & Ohio R. Co.* v. *U.S.*, 386 U.S. 372, 384-6 (1967). See also *Norfolk & W. Ry. Co. and New York C. & St. L.R. Co. Merger*, 324 ICC 1, 85-89 (1964), *Penn-Central and N. & W. Inclusion Cases*, 389 U.S. 486, 500-1 (1968).

[8] *Railroad Com'rs* v. *Portland and O.C.R.R.*, 63 Me. 269, 278 (1872), which was cited by the court of appeals (A.61).

[9] *Id* at 275.

Maine Central Railroad v. *P.U.C.*, 156 Me. 284, 163A.2d 269 (1960) for the proposition that every citizen in Maine has a stake in the health of its railroads. (A.64-5)

The special distinction of railroads insofar as the public interest is concerned, as contrasted with other private corporations, is fundamental to Maine law.

> "In the circumstances of their origin, and in their powers, uses and duties railroad corporations are clearly distinguishable from other merely private corporations; and, unless we keep these characteristics in view when we come to determine the rights, powers and duties of such corporations, and the authority, express, implied or reserved, of the legislature and court in respect to them, we shall run the hazard of confounding dissimilar distinctions and committing grave errors," *R.R. Commissioners* v. *Portland and O.C.R.*, 63 Me. 269, 277 (1872)

Legislation and Administrative Action

The court of appeals correctly observed that the public's special interest in railroads has been reflected in the separate Transportation Acts of 1920 and 1940; enactment of Section 77 of the Bankruptcy Act (1933); and the Commission's current *Northeastern Railroad Order of Investigation* (Ex Parte No. 293). Since the court of appeals decision, Congress has passed and the President has signed, in response to the present rail crisis in the Northeast and and Midwest, the Regional Rail Reorganization Act of 1973 (P.L. 93-236), the first time in its history that the federal government has made a long-term commitment to become involved in railroad operations and management with

taxpayer funds.[10]

The extraordinary "cram down" provisions of a railroad reorganization court under Section 77(e), as contrasted with corresponding provisions (i) under Chapter X reorganizations where the plan must be accepted by creditors holding two-thirds in amount of each class of claims and, if the debtor is not insolvent, by stockholders holding the majority of stock of each class, 11 U.S.C. § 579, and (ii) under Chapter XI arrangements where the arrangement must be accepted by a majority of the creditors in each class holding a majority in amount of the claims in such class (11 U.S.C. § 762), attests to the high priority given to the public interest in railroads, even at the expense of creditors holding first liens and mortgages on rail assets.

Of course, the Interstate Commerce Act itself, 49 U.S.C. §§ 1 *et seq.*, must be considered a manifestation of public interest and concern. To cite but one example from that Act, consider the lengths to which the "public convenience and necessity" is protected when a railroad seeks to discontinue or change service. The Railroad must give advance notice, and the Commission may investigate, hold hearings, and require the railroad to continue the service. 49 U.S.C. § 13a.

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[10] See, *Texas & P. R. Co.* v. *Gulf, C. & S. F. Co.*, 270 U.S. 266, 277 (1926): "Congress . . . recognized that the preservation of earning capacity, and conservation of financial resources, of individual carriers is a matter of national concern . . ." in enacting the Transportation Act of 1920. Maine's direct investment in the Railroad is evidenced by Chapter 250 Private and Special Laws of Maine, 1891 (Pg. 374) and Chapter 193 Private and Special Laws of Maine, 1895 (Pg. 254), both empowering the County of Aroostook "to aid in the construction of a railroad through said County, and to acquire and hold preferred stock of the Company building such railroad."

In *Dayton-Goose Creek R. Co.* v. *U.S.*, 263 U.S. 456 (1924) this Court, in passing upon the rate provisions of the Transportation Act of 1920, stated at 481:

> "The carrier owning and operating a railroad, however strong financially, however economical in its facilities, or favorably situated as to traffic, is not entitled, as of constitutional right, to more than a fair net operating income upon the value of its properties *which are being devoted to transportation.* By investment in a business dedicated to the public service the owner must recognize that, as compared with investment in private business, he cannot expect either high or speculative dividends, but that his obligation limits him to only fair or reasonable profit". (Emphasis added)

What BP and BPO did, we submit, was to take assets of the Railroad, which were being devoted to transportation, and move them upstairs into a private non-regulated business where they would be available to earn more than a regulated reasonable profit without thereafter being reinvested in the Railroad. Clearly, this violated the intent of Congress and the policy which it had established and reaffirmed under the two separate Transportation Acts, and, we suggest, may have been the kind of practice which ultimately produced the rail crisis to which the Regional Rail Transportation Act of 1973 is addressed.

In *Katy Industries, Inc. — Control — M-K-T R.Co.*, 331 I.C.C. 405 (1967), the very same BP and BPO sought control of the M-K-T Railroad under a plan to place ownership of the railroad in a non-carrier holding company which would make investments in high yielding non-transportation companies. The argument was made before the Commission by BP and BPO that the greater return on investments would

be directed back into the railroad — in short, that unregulated profits would be invested in a regulated industry.[11] It is impossible to reconcile BP and BPO's announced purpose to the Commission in the *Katy* case with its action in this case. In fact, the Commission subsequently specifically rejected the argument made by BP and BPO in *Katy*:

> "Bangor Punta group has often been cited by those in favor of railroad diversified holding companies as an example of the railroad receiving benefits from a holding company relationship. The claims were based on the premise that Bangor and Aroostook Railroad service is better because of the capital available for its activities from Bangor Punta, which would not ordinarily be available to the Railroad. This allegedly resulted in an overall improved financial condition of the Railroad.
>
> Our review disclosed the contrary. The Railroad has been contributing funds to the holding company by payment of special dividends; lending funds at rates below prevailing interest rates; using Railroad's credit; and by borrowing funds at local banks to pass on to the holding company.
>
> Regardless of all the glowing self-serving statements made in current merger proceedings, our belief is that when circumstances warrant, these managements will involve the railroads in similar transactions". (ICC Report, at pp. 47-8, *infra*)[12]

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11 The Commission dismissed the case for lack of jurisdiction.

12 The ICC Report also states that "there is no evidence to indicate any concern or consideration was at any time given to the responsibility of the carrier to the public". (at p: 50, *infra*)

C. The Railroad Should Not Be Prevented From Bringing This Action Simply Because Its Present Majority Stockholder Did Not Own Its Stock During The Period Of Wrongful Conduct

The corporations which were subjects of concern in the various cases upon which BP and BPO so completely rely[13], were not public utilities. Recoveries would not accrue substantially to the public's benefit. These corporations were not the subject of repeated Congressional legislation, federal regulation and inquiry. They did not have powers of eminent domain.

The court of appeals rejected *Home Fire's* treatment of the corporation as the alter ego of its stockholders where recovery would benefit persons other than the stockholders. Railroads "cannot realistically be described as mere alter egos of their chief stockholders". (A.59)

We respectfully submit that there are additional reasons why this Court should not follow the *ratio decidendi* of *Home Fire.* In the first place, contrary to the assertion of Petitioners' Brief (Pg. 17), there is considerable authority allowing suits which *Home Fire* would seemingly not allow.[14] Secondly, the Maine cases are disposed to permit such suits. *Hyams* v. *Old Dominion Company,* 113 Me. 294,

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13 *Home Fire Ins. Co.* v. *Barber,* 67 Neb. 644, 93 N.W. 1024 (1903) and like cases *Capital Wine & Spirit Corp.* v. *Pokrass,* 277 App. Div. 184, 98 N.Y.S.2d 291 aff'd, 302 N.Y. 734, 98 N.E.2d 704 (1951); *Amen* v. *Black,* 234 F.2d 12 (CA10 1956) and *Matthews* v. *Headley Chocolate Co.,* 130 Md. 523, 100 A. 645 (1917).

14 Two cases which cite *Home Fire* and refuse to follow it are *Bank* v. *Coal Corp.,* 133 W.Va. 639, 653-5, 57 S.E.2d 736, 746 (1950) and *Peterson* v. *Hopson,* 306 Mass. 597, 611-2, 29 N.E.2d 140, 149 (1940). Earlier cases are collected in Sykes, *Right of a Stockholder to Attack Transactions Occurring Prior to His Acquisition of Stock,* 4 Md.L.Rev. 380, 380 n.2 (1940).

93A.747 (1915), specifically approved in *Forbes* v. *Wells Beach Casino, Inc.*, 307 A.2d 210, 223 (Me. 1973) Thirdly, *Home Fire* itself disregarded the separate corporate entity only in connection with the claims in equity. Judge Pound allowed the corporation to assert claims at law:

> "Hence, we think the rule to apply to such cases is this: where a corporation is proceeding *at law* . . . the corporation is regarded as a person separate and distinct from its stockholders, or any or all of them." *Home Fire Ins. Co.* v. *Barber*, 67 Neb. 644, 679-680, 93 N.W. 1024, 1032 (1903) (emphasis added)[15]

Thus, Barber was held to be liable to the corporation for money converted under guise of paying for services.

BP and BPO's reliance on *Home Fire* depends upon disregarding the separable interests of the Railroad and Amoskeag, possibly because BP and BPO did exactly that while they controlled the Railroad. But in actions at law, as Dean Pound stated, the interests are separable and distinct. We submit that this is also the better rule for suits in equity where legal causes of action are alleged. See *Groome et al* v. *Steward*, 142 F.2d 756, 756 (CADC 1944)

When the scheme of BP and BPO was hatched in 1960, the Railroad was the parent corporation owning two subsidiaries, both engaged in businesses directly related to it. By 1964, the Railroad had become one of five subsidiaries, none of the other four being in a business related to railroading. By 1968, the Railroad was one of some fifty active subsidiaries or divisions of BP and BPO with the businesses of the others completely or largely unrelated to railroad-

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[15] See, also, *Amtorg Trading Corp.* v. *U.S.*, 71 F.2d 524 (C.C.P.A. 1934)

ing.[16] The ICC Report reveals that the Railroad's contribution to consolidated revenues of its parent corporation dropped from 19% in 1964 to only 6% in 1968; that during the same period the Railroad's contribution to consolidated profits of its parent declined from 22% to 1%.[17]

"In such a situation, a holding company might be inclined to dispose of a railroad after having used it advantageously."[18] And that is exactly what happened. On October 2, 1969, BP and BPO sold all of their Railroad stock (98% of the Railroad) to Amoskeag, "whose president, F. C. Dumaine, Jr. and family have long been associated with the railroad industry [and who] . . . formerly was president of the New York, New Haven and Hartford, and the Delaware and Hudson Railroads".[19] It was the first time that a public carrier had been sold by a conglomerate.[20]

By permitting this suit to be maintained, this Court will not open the floodgates to litigation, as BP and BPO argue. The party directly injured is bringing the suit against the wrongdoer. That party, the Railroad, is a public asset. The public has a legitimate interest in the conduct of the Railroad's affairs, evidenced by the legislation and regulation to which it is subject. The case is clearly distinguishable from *Home Fire* and those which follow it. The deterrent

[16] ICC Report, pp. 81-8, *infra*

[17] *Ibid*, p. 47, *infra*

[18] *Ibid*. p. 47, *infra*

[19] *Ibid*. p. 91, *infra*. In ICC Finance Docket No. 26115, Boston and Maine Corporation Reorganization, Amoskeag has filed a plan of reorganization of the Boston and Maine Railroad and has announced its intention of combining that railroad with the Maine Central and the Bangor & Aroostook Railroad into a northern New England system. See *In Re Boston and Maine Corporation*, 484 F.2d 369, 371 (CA1 1973).

[20] ICC Report, p. 48, *infra*

effect of this litigation should not be overlooked. By permitting this suit to be maintained, this Court will be giving effect to the declared federal and state policy of protection of the public interest in railroads and declaring that such public interest is better served by not granting civil immunity "to those who may have syphoned funds from a rail carrier in violation of state and federal law". (A.66-7)

II. THE RAILROAD AND ITS SUBSIDIARY HAVE STANDING TO BRING THIS ACTION BECAUSE THEY HAVE BEEN DIRECTLY INJURED BY BP AND BPO'S ILLEGAL ACTIONS

Conversion

In Count I the Railroad has alleged that its funds were converted by the BP and BPO.[21] (A.8-9) This alone is a more direct and immediate injury than was suffered by the plaintiffs who were held to have standing in *Flast* v. *Cohen*, 392 U.S. 83 (1968), or *Assoc. of Data Processing Service Organizations, Inc.* v. *Camp*, 397 U.S. 150 (1970).

Clayton Act Violation

Standing to sue for violations of the Clayton Act is conferred by Section 4 of the Act, 15 U.S.C. §15, which provides:

> "[A]ny person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue therefor. . ."

Count IV alleges the Railroad has been injured by violation of Section 10 of the Clayton Act, 15 U.S.C. §20, which was enacted:

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21 Diversity jurisdiction is alleged as a jurisdictional basis for this count. (A.1-3) Also there may be pendent jurisdiction.

> "to prohibit a corporation from abusing a carrier by palming off upon it securities . . . without competitive bidding and at excessive prices through overreaching by . . . common directors, to the financial injury of the carrier and the consequent impairment of its ability to serve the public interest." *Minneapolis & S.L. Ry.* v. *United States,* 361 U.S. 173, 190 (1959); quoted in *Klinger* v. *Baltimore and Ohio Railroad Company,* 432 F.2d 506, 512 (CA2 1970).

Here over ten thousand shares of a security were "palmed off" on the Railroad at an excessive price. (A.11-13) The cause of action is not "completely devoid of merit", *Oneida Indian Nation* v. *Oneida,* 42 U.S. Law Week 4195, 4197 (U.S. Sup. Ct., January 21, 1974); the assertion of the cause of action is enough to satisfy jurisdictional requirements. *Romero* v. *International Terminal Operating Co.,* 358 U.S. 354, 359 (1959).

Since the Railroad is the "person injured" within Section 4 and a "carrier" within Section 10, it may assert the cause of action.[22] *Klinger* v. *Baltimore and Ohio Railroad Company,* 432 F.2d 506, 512 (CA2 1970); and see *Cleary* v. *Chalk,* 488 F.2d 1315, 1319 n.17, 1321-4 (CADC 1973) BP and BPO have asserted no rationale, based on the aims and purposes of the antitrust laws why the Railroad should be denied standing. *Perma Life Mufflers* v. *International Parts,* 392 U.S. 134, 143 (1968)

Securities Exchange Act Violation

Similarly, the Railroad and its subsidiary have standing to assert the violations of Rule 10b-5 alleged in Counts VI,

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[22] Amoskeag, as a stockholder of an injured corporation, is not a "person injured" within Section 4. *Kauffman* v. *Dreyfus Fund, Inc.,* 434 F.2d 727, 732 (CA3 1970), cert. denied 401 U.S. 974.

VIII, X and XIII of the Amended Complaint. (A.14-20) As this Court has held, "[Rule 10b-5] protects corporations as well as individuals who are sellers of a security." *Superintendent of Insurance* v. *Bankers Life and Casualty Co.*, 404 U.S. 6, 10 (1971). A majority stockholder, such as BP and BPO, may be held liable to the corporations it controls for violations of Rule 10b-5. *Schoenbaum* v. *Firstbrook*, 405 F.2d 215, 219 (CA2 1968) (in banc), cert. denied 395 U.S. 906. Existence of a remedy under state law does not negate the federal remedy. *Vine* v. *Beneficial Finance Company*, 374 F.2d 627, 635-6 (CA2 1967), cert. denied 389 U.S. 970. This Court has said:

> "Since there was a 'sale' of a security and since fraud was used 'in connection with' it, there is redress under Section 10(b), whatever might be available as a remedy under state law." *Superintendent of Ins.* v. *Bankers Life and Cas. Co.*, 404 U.S. 6, 12 (1971)

The Railroad and its subsidiary have alleged (A.10-15) a sale of securities and fraud and damages relating thereto, and therefore they have stated causes of action under Section 10(b).[23]

In actions under Rule 10b-5 courts have approved "windfall" recoveries rather than let a wrongdoer profit from illegal acts. In *Janigan* v. *Taylor*, 344 F.2d 781 (CA1 1965), cert. denied 382 U.S. 879, the court held at 786, "It is more appropriate to give the defrauded party the benefit even of windfalls than to let the fraudulent party keep them." This rule of damages, along with the *Janigan* case, was cited with

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[23] Since Amoskeag was not a seller of the St. Croix stock, it would not have standing itself under Section 10(b) to challenge the St. Croix transaction. *Birnbaum* v. *Newport Steel Corp.*, 193 F.2d 461, 464 (CA2 1952), cert. denied 343 U.S. 956.

approval in *Affiliated Ute Citizens* v. *U.S.*, 406 U.S. 128, 155 (1972).[24]

In view of the law cited herein and of the injuries and damages suffered, the Railroad and its subsidiary have alleged causes of action within the traditional boundaries of Maine common law, of Section 10 of the Clayton Act, and of SEC Rule 10b-5. There is no language in the decision below that creates any new "unsanctioned" causes of action, as BP and BPO argue in their brief, pp. 11-16. The court of appeals did not discuss the boundaries of causes of action under the Clayton Act or under Rule 10b-5, because BP and BPO did not raise these issues below. While BP and BPO did argue below the scope of the cause of action, if any, under the Maine Public Utilities Act, the court of appeals declined to pass on this issue. (A.67) Thus, the decision below did not create any cause of action, let alone an "unsanctioned" one, under this statute.

Since it was the Railroad and its subsidiary that had their assets converted, that were injured in their business and property, and that sold the St. Croix stock, the Railroad and its subsidiary should be allowed to maintain this action.

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24 See also the cases that allow a tippee to recover damages from his tipper, e.g. *Nathanson* v. *Weis, Voisin, Cannon, Inc.*, 325 F.Supp. 50, 57-8 (S.D.N.Y. 1971) and that allow an investor to recover damages from his broker for violation of the margin requirements, e.g. *Pearlstein* v. *Scudder & German*, 429 F.2d 1136, 1141 (CA2 1970), cert. denied 401 U.S. 1013. Clearly, in furtherance of the policy of deterring unlawful acts, the courts have permitted recovery under the securities laws when plaintiff itself may be a wrongdoer. In this case, neither the Railroad nor Amoskeag is a wrongdoer, as recognized in the court of appeals opinion. (A.65)

III. RULE 23.1 SHOULD NOT BE APPLIED TO PREVENT THE RAILROAD FROM MAINTAINING THIS ACTION

A. The Language and Purposes of Rule 23.1 Are Inapplicable.

Rule 23.1 applies to derivative actions where the directors of a corporation have refused to act for and in its behalf. Thus, the plaintiff is required to allege "with particularity the efforts, if any, made by the plaintiff to obtain the action he desires from the directors". The purpose of Rule 23.1 is to regulate when a suit may be controlled by a stockholder rather than the board of directors of the corporation. *In re Kauffman Mutual Fund Actions,* 479 F.2d 257, 263 (CA1 1973), cert. denied ~~No.~~—U.S.—, 38 L.Ed.2d 107. But here the Railroad's Board authorized this suit to be brought by the Railroad itself, under the control of the Chief Executive Officer of the corporation subject to review by the directors. (A.43-7) Rule 23.1 does not apply to this situation. *Mauck* v. *Mading-Dugan Drug Company,* 361 F.Supp. 1314, 1318 (N.D. Ill. 1973), *Central Ry. Signal Co.* v. *Longden,* 194 F.2d 310, 321 (CA7 1952) (alternate holding).

Further the purposes behind Rule 23.1 do not apply here. As the court of appeals wrote in its decision:

> "The underlying policies for adoption of the Rule — preventing transfer of a few shares to a non-resident to acquire diversity jurisdiction and to discourage strike suits — relate to abuses associated with minority stockholder proceedings. See *Hawes* v. *Oakland,* 104 U.S. 450 (1882); 3B Moore's Federal Practice, Paragraph 23.1.15" (A.60)

Since the reasons behind Rule 23.1 do not apply, the rule itself should not be applied. *Surowitz* v. *Hilton Hotels Corp.,* 383 U.S. 363, 371 (1966), *Hirshfield* v. *Briskin,* 447

F.2d 694, 698 (CA7 1971), *Bateson* v. *Magna Oil Corporation*, 414 F.2d 128, 131 (CA5 1969), cert. denied 397 U.S. 911, *Hoff* v. *Sprayregan*, 52 F.R.D. 243, 247 (S.D.N.Y. 1971)

B. Rule 23.1 Is Procedural And May Not Be Used To Deny The Railroad Its Substantive Rights

The federal rules may not be given substantive effect, because they were adopted pursuant to Congressional authorization requiring that they "shall not abridge . . . or modify any substantive right." 28 U.S.C. § 2072. See *Sibbach* v. *Wilson*, 312 U.S. 1, 13 (1940), reh. denied 312 U.S. 655.

BP and BPO by their motion for summary judgment are attempting to use Rule 23.1 in a substantive manner to provide an affirmative defense on the merits. (A. 29, 41) The court of appeals, perceiving that BP and BPO were asserting the contemporaneous ownership rule as a defense against the *Railroad's* maintaining the suit, correctly analyzed the issue before it as "whether the corporation, suing in its own right, should be estopped by equitable defenses pertaining only to its controlling stockholder". (A.60) But:

> "Simply because a particular [plaintiff-stockholder] cannot qualify as a proper party to maintain [a derivative] action does not destroy or even whittle at the cause of action. The cause of action exists until a qualified plaintiff can get it started in a federal court." *Perrott* v. *United States Banking Corp.*, 53 F.Supp. 953, 956 (D.Del. 1944); cited with approval in the Advisory Committee Note of 1946 to Rule 23.1, 3B Moore's *Federal Practice*, p. 23.1-15. See also *Ross* v. *Bernhard*, 396 U.S. 531, 538 (1970).

If this Court were to determine, as did the district court, that this was Amoskeag's suit, the proper result would be to hold that Amoskeag does not have standing to bring a suit

on behalf of the Railroad. But any of the Railroad's other stockholders could cause the Railroad to bring the action by making demand upon the Railroad, or could even intervene to carry on this suit. *Truncale* v. *Universal Pictures Co.*, 11 F.R. Serv. 24c.3, Case 1 (S.D.N.Y. 1948). In such a case, the Railroad's recovery would be its full damages; there is no pro-rata reduction of recovery as BP and BPO contend. *Norte & Company* v. *Huffines,* 416 F.2d 1189, 1190 (CA2 1969), cert. den. 397 U.S. 989. *Central Ry. Signal* v. *Longden,* 194 F.2d 310, 321-2 (CA7 1952); *Overfield* v. *Pennroad Corp.,* 48 F.Supp. 1008, 1018 (E.D.Pa. 1943), modified 146 F.2d 889 (CA3 1943). The present stockholders who were not stockholders at the time of the wrongs sued upon, such as Amoskeag, "are not unjustly enriched by the award to the corporation because at the time of purchase they acquired a proportionate indivisible interest in the claims asserted" in the action in the corporation's behalf. *Norte & Company* v. *Huffines,* 288 F.Supp. 855, 865 (S.D.N.Y. 1968), affirmed 416 F.2d 1189, cert. den. 397 U.S. 989.

Thus, Rule 23.1 may not be used as a basis for dismissing on the merits the claims brought by the Railroad and its subsidiary.

IV. THE DISTRICT COURT MAY FRAME A DECREE TO INSURE THAT ANY RECOVERY WILL NOT BENEFIT THE PRESENT MAJORITY STOCKHOLDER AT THE EXPENSE OF THE RAILROAD AND THE PUBLIC.

The "windfall" if any, which is said will be available to Amoskeag if recovery is obtained, may be circumscribed in such a way as to insure that it will be used for the benefit of the railroad. The court of appeals had no doubt that the district court has power to frame a decree which would prohibit distributions by the Railroad which would conflict with state or federal law. We submit that the broad powers of

the district court, which can act as a court of equity for purposes of framing a decree in an action at law, are sufficient to insure that any recovery would be reinvested in the Railroad for, as examples, upgrading of way or purchasing of equipment. But if such power is not sufficient, the Railroad stated to the district court that the Railroad would voluntarily enter into a Stipulation to such effect, in which Amoskeag would volunarily join if requested.

In *J. I. Case Co.* v. *Borak,* 377 U.S. 426 (1964) where this Court recognized a private right of action for violation of Section 14(a) of the Securities Exchange Act of 1934, it was held that the courts were "to be alert to provide such remedies as are necessary to make effective the Congressional purpose" of the legislation involved. *Id.* at 433-4. In *Mills* v. *Electric Auto-Lite Co.,* 396 U.S. 375 (1970) it was observed that in selecting a remedy the lower courts should exercise the sound discretion which guides the determinations of courts of equity. *Id* at 386. And see *Hecht Co.* v. *Bowles,* 321 U.S. 321, 329-330 (1944), and *Meredith* v. *Winter Haven,* 320 U.S. 228, 235 (1943). In *Bell* v. *Hood,* 327 U.S. 678 (1946) this Court declared at 684:

> ". . . where federally protected rights have been invaded, it has been the rule from the beginning that courts will be alert to adjust their remedies so as to grant the necessary relief. And it is also well settled that where legal rights have been invaded, and a federal statute provides for a general right to sue for such invasion, federal courts may use any available remedy to make good the wrong done."

Improved equipment and rights of way of the Railroad may indirectly benefit Amoskeag by increasing the value of its equity. But such expenditures do not necessarily increase the price Amoskeag would receive if it were to sell its stock.

The value of the stock of solvent railroads for consolidation or sale purposes is determined by a number of factors, including earning capacity, historical income (with nonrecurring items eliminated), balance sheet strength, savings that might be effected as a result of the consolidation or purchase, dividend history and condition of plant and equipment. Under a suitably framed decree only the last of these factors would be directly enhanced by the Railroad's recovery.

In *Home Telephone* v. *Darley*, 355 F.Supp. 992 (N.D. Miss. 1973), the court declared at 998:

> "We are not impressed with the argument that a recovery by Home for its substantial loss, thus being restored to its former net worth position, is a 'reward' to Union. A recovery in this case will inure directly to Home's benefit, and only incidentally to Union as sole common shareholder."

There is no question, however, that the public would be the immediate beneficiary of improved equipment and way.

The district courts have shown considerable ingenuity and imagination in fashioning decrees, particularly in the antitrust area. *United States* v. *Ford Motor Company*, 286 F.Supp. 407 (E.D.Mich. 1967), 315 F.Supp. 372 (E.D.Mich. 1970), affirmed 405 U.S. 562 (1972) Their combined law and equity power may be employed to insure that full justice is done.[25]

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[25] Divestiture and a mandatory injunction are available to a private plaintiff bringing an action under Section 16 of the Clayton Act. *International T. & T. Corp.* v. *General Telephone & Electric Corp.*, 351 F.Supp. 1153 (D.Haw. 1972). See also, *Groome et al* v. *Steward*, 142 F.2d 756 (C.A.D.C. 1944) where the distinction between law and equity is erased (except in jury trials) and the parties must be given relief to which they are entitled on the facts, "applying the rules of both law and equity as a single body of principles and precedents". *Id at* 756.

We submit that, if syphoning off of the Railroad's recovery is a major concern for this Court, an appropriate decree or stipulation may be framed to remove such concern.

CONCLUSION

For all these reasons, the judgment below should be affirmed.

In the court of appeals the Railroad and its subsidiary argued that the *Home Fire* rationale[26] should not be applied to bar claims under the Federal antitrust and securities laws.[27] The court of appeals reserved judgment on these points. (A.59) If the judgment is to be reversed on the basis of the *Home Fire* rationale, and if this Court does not pass on the arguments reserved in the court of appeals, then this Court should remand this case to the court of appeals to have these arguments passed upon.

Respectfully submitted.

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[26] See Petitioners' Brief, p. 17-18.

[27] The arguments made by the Railroad in the court of appeals are summarized in Appendix C, pp. 103-4 below.

APPENDIX A

STATUTES AND REGULATIONS INVOLVED

Clayton Act § 4 (15 U.S.C. § 15):

[Suits by persons injured]

Sec. 4. That any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue therefor in any district court of the United States in the district in which the defendant resides or is found or has an agent without respect to the amount in controversy, and shall recover threefold the damages by him sustained, and the cost of suit, including a reasonable attorney's fee.

Interstate Commerce Act § 5(2) (49 U.S.C. § 5(2):

§ 5, par. (2). **Unifications, mergers, and acquisitions of control.** (a) It shall be lawful, with the approval and authorization of the Commission, as provided in subdivision (b) of this paragraph—

(i) for two or more carriers to consolidate or merge their properties or franchises, or any part thereof, into one corporation for the ownership, management, and operation of the properties theretofore in separate ownership; or for any carrier, or two or more carriers jointly, to purchase, lease, or contract to operate the properties, or any part thereof, of another; or for any carrier, or two or more carriers jointly, to acquire control of another through ownership of its stock or otherwise; or for a person which is not a carrier to acquire control of two or more carriers through ownership of their stock or otherwise; or for a person which is not a carrier and which has control of one or more carriers to acquire control of another carrier through ownership of its stock or otherwise; or

(ii) for a carrier by railroad to acquire trackage rights over, or joint ownership in or joint use of, any railroad line or lines owned or operated by any other such carrier, and terminals incidental thereto.

(b) Whenever a transaction is proposed under subdivision (a) of this paragraph, the carrier or carriers or person seeking authority therefor shall present an application to the Commission, and thereupon the Commission shall notify the Governor of each State in which any part of the properties of the carriers involved in the proposed transaction is situated, and also such carriers and the applicant or applicants (and, in case carriers by motor vehicle are involved, the persons specified in section 305(e) of this title), and shall afford reasonable opportunity for interested parties to be heard. If the Commission shall consider it necessary in order to determine whether the findings specified below may properly be made, it shall set said application for public hearing; and a public hearing shall be held in all cases where carriers by railroad are involved unless the Commission determines that a public hearing is not necessary in the public interest. If the Commission finds that, subject to such terms and conditions and such modifications as it shall find to be just and reasonable, the proposed transaction is within the scope of subdivision (a) of this paragraph and will be consistent with the public interest, it shall enter an order approving and authorizing such transaction, upon the terms and conditions, and with the modifications, so found to be just and reasonable: *Provided,* That if a carrier by railroad subject to this chapter, or any person which is controlled by such a carrier, or affiliated therewith within the meaning of paragraph (6) of this section, is an applicant in the case of any such proposed transaction involving a motor carrier, the Commission shall not enter such an order

unless it finds that the transaction proposed will be consistent with the public interest and will enable such carrier to use service by motor vehicle to public advantage in its operations and will not unduly restrain competition.

(c) In passing upon any proposed transaction under the provisions of this paragraph, the Commission shall give weight to the following considerations, among others: (1) The effect of the proposed transaction upon adequate transportation service to the public; (2) the effect upon the public interest of the inclusion, or failure to include, other railroads in the territory involved in the proposed transaction; (3) the total fixed charges resulting from the proposed transaction; and (4) the interest of the carrier employees affected.

(d) The Commission shall have authority in the case of a proposed transaction under this paragraph involving a railroad or railroads, as a prerequisite to its approval of the proposed transaction, to require, upon equitable terms, the inclusion of another railroad or other railroads in the territory involved, upon petition by such railroad or railroads requesting such inclusion, and upon a finding that such inclusion is consistent with the public interest.

(e) No transaction which contemplates a guaranty or assumption of payment of dividends or of fixed charges, shall be approved by the Commission under this paragraph except upon a specific finding by the Commission that such guaranty or assumption is not inconsistent with the public interest. No transaction shall be approved under this paragraph which will result in an increase of total fixed charges, except upon a specific finding by the Commission that such increase would not be contrary to public interest.

(f) As a condition of its approval, under this paragraph, of any transaction involving a carrier or carriers by railroad

subject to the provisions of this chapter, the Commission shall require a fair and equitable arrangement to protect the interests of the railroad employees affected. In its order of approval the Commission shall include terms and conditions providing that during the period of four years from the effective date of such order such transaction will not result in employees of the carrier or carriers by railroad affected by such order being in a worse position with respect to their employment, except that the protection afforded to any employee pursuant to this sentence shall not be required to continue for a longer period, following the effective date of such order, than the period during which such employee was in the employ of such carrier or carriers prior to the effective date of such order. Notwithstanding any other provisions of this chapter and chapters 8 and 12 of this title, an agreement pertaining to the protection of the interests of said employees may hereafter be entered into by any carrier or carriers by railroad and the duly authorized representative or representatives of its or their employees.

Interstate Commerce Act § 13a (49 U.S.C. § 13a):

[Discontinuance or change of the operation or service of trains or ferries; notice; investigation; hearing; determination]

(1) A carrier or carriers subject to this chapter, if their rights with respect to the discontinuance or change, in whole or in part, of the operation or service of any train or ferry operating from a point in one State to a point in any other State or in the District of Columbia, or from a point in the District of Columbia to a point in any State, are subject to any provision of the constitution or statutes of any State or any regulation or order of (or are the subject of any

proceeding pending before) any court or an administrative or regulatory agency of any State, may, but shall not be required to, file with the Commission, and upon such filing shall mail to the Governor of each State in which such train or ferry is operated, and post in every station, depot or other facility served thereby, notice at least thirty days in advance of any such proposed discontinuance or change. The carrier or carriers filing such notice may discontinue or change any such operation or service pursuant to such notice except as otherwise ordered by the Commission pursuant to this paragraph, the laws or constitution of any State, or the decision or order of, or the pendency of any proceeding before, any court or State authority to the contrary notwithstanding. Upon the filing of such notice the Commission shall have authority during said thirty days' notice period, either upon complaint or upon its own initiative without complaint, to enter upon an investigation of the the proposed discontinuance or change. Upon the institution of such investigation, the Commission, by orders served upon the carrier or carriers affected thereby at least ten days prior to the day on which such discontinuance or change would otherwise become effective, may require such train or ferry to be continued in operation or service, in whole or in part, pending hearing and decision in such investigation, but not for a longer period than four months beyond the date when such discontinuance or change would otherwise have become effective. If, after hearing in such investigation, whether concluded before or after such discontinuance or change has become effective, the Commission finds that the operation or service of such train or ferry is required by public convenience and necessity and will not unduly burden interstate or foreign commerce, the Commission may by order require the continuance or restoration

of operation or service of such train or ferry, in whole or in part, for a period not to exceed one year from the date of such order. The provisions of this paragraph shall not supersede the laws of any State or the orders or regulations of any administrative or regulatory body of any State applicable to such discontinuance or change unless notice as in this paragraph provided is filed with the Commission. On the expiration of an order by the Commission after such investigation requiring the continuance or restoration of operation or service, the jurisdiction of any State as to such discontinuance or change shall no longer be superseded unless the procedure provided by this paragraph shall again be invoked by the carrier or carriers.

(2) Where the discontinuance or change, in whole or in part, by a carrier or carriers subject to this chapter, of the operation or service of any train or ferry operated wholly within the boundaries of a single State is prohibited by the constitution or statutes of any State or where the State authority having jurisdiction thereof shall have denied an application or petition duly filed with it by said carrier or carriers for authority to discontinue or change, in whole or in part, the operation or service of any such train or ferry or shall not have acted finally on such an application or petition within one hundred and twenty days from the presentation thereof, such carrier or carriers may petition the Commission for authority to effect such discontinuance or change. The Commission may grant such authority only after full hearing and upon findings by it that (a) the present or future public convenience and necessity permit of such discontinuance or change, in whole or in part, of the operation or service of such train or ferry, and (b) the continued operation or service of such train or ferry without discontinuance or change, in whole or in part, will constitute

an unjust and undue burden upon the interstate operations of such carrier or carriers or upon interstate commerce. When any petition shall be filed with the Commission under the provisions of this paragraph the Commission shall notify the Governor of the State in which such train or ferry is operated at least thirty days in advance of the hearing provided for in this paragraph, and such hearing shall be held by the Commission in the State in which such train or ferry is operated; and the Commission is authorized to avail itself of the cooperation, services, records and facilities of the authorities in such State in the performance of its functions under this paragraph.

Judiciary Code, § 2072 (28 U.S.C. § 2072):

[Rules of civil procedure for district courts]

The Supreme Court shall have the power to prescribe by general rules, the forms of process, writs, pleadings, and motions, and the practice and procedure of the district courts and courts of appeals of the United States in civil actions, including admiralty and maritime cases, and appeals therein, and the practice and procedure in proceedings for the review by the courts of appeals of decisions of the Tax Court of the United States and for the judicial review or enforcement of orders of administrative agencies, boards, commissions, and officers.

Such rules shall not abridge, enlarge or modify any substantive right and shall preserve the right of trial by jury as at common law and as declared by the Seventh Amendment to the Constitution.

Such rules shall not take effect until they have been reported to Congress by the Chief Justice at or after the beginning of a regular session thereof but not later than the

first day of May, and until the expiration of ninety days after they have been thus reported.

All laws in conflict with such rules shall be of no further force or effect after such rules have taken effect. Nothing in this title, anything therein to the contrary notwithstanding, shall in any way limit, supersede, or repeal any such rules heretofore prescribed by the Supreme Court.

Maine Public Utilities Act § 15 (35 M.R.S.A. § 15):

[Definitions]

3. Common Carrier. "Common carrier" includes every railroad company, express company, dispatch, sleeping car, dining car, drawing-room car, freight line, refrigerator, oil, stock, fruit, car loaning, car renting, car loading and every other car corporation or person, their lessees, trustees, receivers, or trustees appointed by any court whatsoever, operating for compensation within this State; and every corporation or person, their lessees, trustees, receivers or trustees appointed by any court whatsoever, owning, controlling, operating or managing any vessel regularly engaged in the transportation of persons or property for compensation upon the waters of this State or upon the high seas, over regular routes between points within this State.

13. Public utility. "Public utility" includes every common carrier, gas company, natural gas pipeline company, electrical company, telephone company, telegraph company, water company, public heating company, wharfinger and warehouseman, as those terms are defined in this section, and each thereof is declared to be a public utility and to be subject to the jurisdiction, control and regulation of the commission, and to chapters 1 to 17.

14. Railroad. "Railroad" includes every commercial, interurban and other railway and each and every branch and extension thereof by whatsoever power operated, together with all tracks, bridges, trestles, rights-of-ways, subways, tunnels, stations, depots, union depots, ferries, yards, grounds, terminals, terminal facilities, structures and equipment and all other real estate, fixtures and personal property of every kind used in connection therewith, owned, controlled, operated or managed for public use in the transportation of persons or property.

15. Railroad company. "Railroad company" includes every corporation or person, their lessees, trustees, receivers or trustees appointed by any court whatsoever, owning, controlling, operating or managing any railroad for compensation within this State.

RESPONDENT'S BRIEF

APPENDIX B

REPORT TO THE COMMISSION

REVIEW OF DIVERSIFIED HOLDING COMPANY RELATIONSHIPS AND TRANSACTIONS OF BANGOR PUNTA CORPORATION

BUREAU OF ACCOUNTS
INTERSTATE COMMERCE COMMISSION
FEBRUARY 1971

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REVIEW OF DIVERSIFIED HOLDING COMPANY RELATIONSHIPS AND TRANSACTIONS OF BANGOR PUNTA CORPORATION

HIGHLIGHTS

PURPOSE OF THE REVIEW

The purpose of the review was to explore the impact of the Bangor Punta Corporation on the Bangor & Aroostook Railroad while it was owned by and under the control of this diversified holding company and to determine whether or not the intercompany relationships and resulting financial transactions were detrimental to the carrier.

FINDINGS AND CONCLUSIONS

There were numerous instances found where management and control of the carrier's assets by the holding company proved detrimental to it. The principal findings are:

. . . Carrier's assets were removed through payment of management fees, questionable dividend practices, and transfers of marketable securities which contributed to a cash problem.

. . . Carrier received no credit for its operating losses and investment tax credits contributed to the consolidated federal income tax return.

. . . Carrier denied investment opportunities because of holding company restrictions on its use of cash.

. . . Carrier's costs were increased through improper allocation of expenses and the performance of clerical services.

. . . Holding company expansion objectives were enhanced through diversion of carrier assets and use of its management talent.

. . . Holding company, although showing a loss of $13 million in press releases, actually realized a net cash gain when it disposed of its investment in the carrier.

In the context of this study, it is clear that when a holding company obtains control over a carrier, transportation management takes a "backseat" and serving the public interest is a secondary consideration.

RECOMMENDATIONS

We recommend that all legal remedies be explored to require the holding company, which sold the carrier, to pay back to the carrier for assets taken with no compensation and charges made where no services were performed.

INTRODUCTION

The Bureau of Accounts has made a review of selected financial transactions of the Bangor & Aroostook Railroad Company (carrier). The highlights of this review are shown in the preceding section of this report.

This examination was a followup to our preliminary findings which were reported in our Special Review of Railroad Conglomerates dated March 11, 1969.

Since that report was made, Bangor Punta Corporation sold its stock ownership in the carrier on September 30, 1969 to Amoskeag Company (Amoskeag), an investment company. For information on Amoskeag see Appendix IV.

In our report of March 11, 1969 we commented in Section VI POTENTIAL QUESTIONABLE PRACTICES that:

"2. *Divestiture of railroad*

A railroad's position in the conglomerate group becomes less important as the holding company grows financially. For example, Bangor Punta's annual report to stockholders for the year ended September 30, 1968 showed that the Railroad's contribution to revenues was 19 percent in 1964 and only 6 percent in 1968. In the same period, the contribution to consolidated profits declined from 22 percent to 1 percent. In such situation, a holding company might be inclined to dispose of a railroad after having used it advantageously.

"This situation would prevail where a holding company would dispose of a carrier after it had utilized all tax benefits, sold all valuable assets, and also under maintained the plant. In fact, a holding company might be forced to do this, as a result of stockholder demands, when a carrier shows operating losses for a few years."

The Commission also has before it an application of the North Western Employees Transportation Corporation for authority to purchase and operate the Chicago and North Western Railway Company, which is controlled by Northwest Industries.

Further in our report of March 11, 1969 in our conclusions we stated:

"We recognize there are many railroad officials who contend that corporate diversification is the answer to their financial problems. The results of the staff's audit, although limited, indicate that one of the shining examples of benefits of corporate conglomerate arrangements may be slightly overstated.

"Bangor Punta group has often been cited by those in favor of railroad diversified holding companies as an example of the railroad receiving benefits from a hold-

ing company relationship. The claims were based on the premise that Bangor & Aroostook Railroad service is better because of the capital available for its activities from Bangor Punta, which would not ordinarily be available to the Railroad. This allegedly resulted in an overall improved financial condition of the Railroad.

"Our review disclosed the contrary. The Railroad has been contributing funds to the holding company by payment of special dividends; lending funds at rates below prevailing interest rates; using Railroad's credit; and by borrowing funds at local banks to pass on to the holding company.

"Regardless of all the glowing self-serving statements made in current merger proceedings, our belief is that when circumstances warrant, these managements will involve the railroads in similar transactions. For certainly, holding company managements, in addition to their own strong self-interests will owe their allegiance to the stockholders of the holding company and not to the railroad or any individual part of the conglomerate."

The findings and conclusions in our report also include some of those contained in a staff report on "Conglomerate Merger Activity" dated March 31, 1969, and in legislative proposals recently submitted to the Congress.

The text of this report identifies problem areas, our proposals to correct them, and the details of each questionable practice.

This is the initial report submitted concerning the sale of a carrier involved in a diversified holding company arrangement. In it we have attempted to demonstrate the effect of the stewardship of the holding company on the carrier and of the resultant limitation placed on the ability of the car-

rier to carry out its transportation responsibilities to the public where its parent holding company is not wholly committed to the transportation needs of the public.

A brief history of the carrier's involvement in a diversified holding company relationship indicates that a management consultant was engaged to launch the carrier into profitable diversified activities. As a result of management's interests in activities other than transportation, Nicolas Salgo was engaged to assist it in this diversification program. The details of Mr. Salgo's involvement with the carrier are shown in Appendix V.

A summary of Mr. Salgo's activities is as follows:

. . . he was engaged at a salary of $12,000 per year, plus stock options.

. . . he then advised the carrier to form a holding company to accomplish its diversification program. The carrier thereupon created Bangor & Aroostook Corporation on December 1, 1960.

. . . he then advised the newly organized holding company (Bangor & Aroostook Corporation) to acquire a corporation in which his family had a considerable stock investment.

. . . he advised the carrier to merge its holding company (B&A Corp.) with a holding company controlled by his interest,Punta Alegre Sugar Corp. This was accomplished on October 13, 1964.

. . . certain key officials of the carrier were given bonuses and salary increases. For example, the salary of Mr. Robertson, Chairman of the Board of the B&A Corp., was increased from $36,000 to $100,000.

After using carrier resources such as:

management talent

cash

declaration of special dividends
current tax benefits
relieving it of possible future tax benefits

The carrier was sold by the holding company to Amoskeag Company, an investment firm.

In four years, Mr. Salgo obtained control of the carrier and its resources. The carrier was subsequently disposed of when it failed to meet Punta's corporate objective which was to secure the highest possible rate of return on investment.[1]

There is no evidence to indicate that any concern or consideration was at any time given to the responsibility of the carrier to the public. The entire transaction, in our judgment, from its inception to the ultimate sale of the carrier served the objectives of Punta.

We searched for benefits from the carrier's relationship with this diversified holding company group. We were unable to determine any instance which would show any transaction which was conceived for the benefit of the carrier. Because this was the initial case where a carrier was sold by a diversified holding company, the question of any possible benefits derived from the carrier's participation in a conglomerate arrangement was discussed with carrier management. We asked carrier officials — what benefits did the carrier receive from the holding company? How did they help you? One of the officials of the carrier responded by indicating the Punta group "used our talent — provided

[1] From Annual Report (to shareholders) for the year ended Sept. 30, 1968: "In accordance with our policy of continuously reviewing the return on investment which our operations produce, we determined that our Pacific Coast foundry operation was not meeting our corporate goals and it was disposed of during the year." A similar determination was made with respect to the Bangor & Aroostook Railroad within the following year.

none, they used our credit, cash and financial ability." He further indicated that he could not give any specific benefits the carrier derived — but one — they sold us to Amoskeag. In connection with this statement, it would be well to consider in conjunction therewith, the remarks embraced in a memorandum subject "Post Sale Comments," page 32 of this report. Another top management official responded by stating that ownership by Amoskeag was a definite "plus," that the carrier had been the "underdog" in the Punta group. While the latter official declined to criticize, he was silent with regard to any benefits derived from Punta. Both officials were enthusiastic about the change in ownership.

Mr. W. Jerome Strout, carrier President and former Vice President and Director of Punta, in responding to a request for his opinion of the impact that Punta had on the carrier pointed out in a carefully worded statement dated 9/18/70; that the sale will benefit both employees and customers and that the change in ownership will result in the availability of financial assistance and railroad know-how which "would not be available if the railroad were still owned by one thousand odd stockholders."[1] Mr. Strout stressed the benefits of change in ownership and made no reference to benefits received from Punta.

In an article appearing in *Railway Age* on April 21, 1969, Mr. Jervis Langdon, Jr., who is now a trustee of the Penn Central Transportation Co. and who was then Chairman and President of the Chicago, Rock Island and Pacific Railroad Co., expressed some of the staff's conclusions on carrier involvement with diversified holding companies.

> " 'The principal reason for my doubt is that railroads with earnings from conglomerates may find it easier to avoid the tough decisions that are necessary to solve

[1] Reference is made to Punta stockholders.

the railroad service problem — and the service problem must come ahead of everything else, even earnings.' "

He also commented:

" 'I realize that lack of capital for improvements running into the billions has a direct bearing upon the railroad service problems, and that conglomerates, with their promise of greater earnings and financial strength, should be able to help in this connection. But would they really help when the choice is between a railroad investment which produces a small return and another investment which promises a much greater return? I wonder to what extent conglomerates, with earnings from diverse sources, can afford to pump into their railroad subsidiaries the kind of money that is required, particularly when there are so many attractive investment opportunities outside the railroad business.

"In the final analysis, he said, there must be recognition that 'the railroad service problem is tough and calls for heroic measures. Only the full and undivided attention of the first team of railroad management, with a willingness truly to cooperate, can possibly come to the rescue. The problem will never be solved if it is regarded as only another routine problem for someone else to worry about while the first management team is preoccupied with more acquisitions for the conglomerate and more earnings for non-transportation sources.

'And if the service problem is not solved, the shippers of the country, finally losing all patience, will demand a change, and what change can there be other than nationalization even though nationalization has not always been a satisfactory answer in other countries? Moreover, if the railroads in the meantime have

become conglomerate subsidiaries, a government take-over might be highly welcome. In the history of our country there have been many instances of the spinning off by private enterprise of public service undertakings, and they have invariably ended up in public ownership. There is ample precedent in our own country for the public ownership of railroads.' "

The above quote from Mr. Langdon summarizes many of the problems encountered with our review of railroad involvement with diversified holding companies.

RECOMMENDATIONS

The Bureau of Accounts believes that the policies, practices and procedures carried out by the holding company were not in the best interest of a viable transportation system. In no instance in the conduct of management can we find where the interest of the carrier held precedence over that of Bangor Punta Corporation.

We believe that the recommendations contained in the staff report on "Conglomerate Merger Activities" dated March 31, 1969, would prevent many of the practices considered detrimental to the carrier's ability to provide an efficient transportation service.

Specific Recommendations With Regard To Punta

That Punta be required to make restitution of assets taken from the carrier with respect to three items: (1) That action be taken against the carrier with regard to requiring Punta to pay back the $528,000 in management fees or so-called corporate charges paid to Punta for which the carrier derived no benefit.

(2) That action be taken to require Punta to pay back to the carrier $63,535, which was the amount of overpayment

to Punta in connection with a tax deficiency assessment described under caption Special Corporate Charges.

(3) That similar action be taken against the carrier to require that Punta make payment to the carrier for benefits totaling approximately $3.2 million derived from the carrier's contribution as a participant in the consolidated federal income tax returns (including interest thereon to be computed at prime interest rates).

While recognition is given to the adverse effect of such restitution on Punta's stockholders, and the apparent gift to Amoskeag's stockholders, our primary concern is that carrier assets remain with the carrier for use in maintaining or improving its transportation service to the public. In connection with any such repayment, adequate safeguards should be established to ensure that the funds remain with the carrier and are not removed by the new owners through the dividend route or by any other method. Such safeguards would have to be established prior to any action taken.

In the text of this report, we have indicated the actions believed necessary to control questionable practices disclosed herein. Generally, these include the following:

(1) That contractual arrangements regarding management fees be reported to the Commission for approval, and that all details of such arrangements be disclosed in reports to the Commission.

(2) That special dividend proposals be submitted to the Commission for prior approval.

(3) That intercompany transactions which result in a transfer of assets from the carrier or its subsidiaries to other members of the group require Commission approval.

(4) That agreements respecting the method of allocating tax liability between participants in a consolidated return be reported to the Commission for its approval, and where

such agreements are not in the public interest the carrier will not be able to participate in the filing of a consolidated return; and that the amount of contributions or reimbursement received by the carrier be fully disclosed in reports to the Commission.

(5) That Commission approval be a prerequisite to all plans that place control of carrier's cash and other assets in the hands of the holding company.

We recommend also that appropriate steps be taken to require Punta to make its 1969 consolidated federal income tax return and working papers[1] available for inspection to Commission representatives.

Finally, we recommend that new regulations be established to prevent diversion of management talent and diversion of assets, to the extent that carriers be precluded from participating in conglomerate activities where such activities cannot be clearly shown to be in the public interest.

Because of our further review of diversified holding companies, the Bureau now firmly believes that to avoid further erosion of the public transportation service, the companies providing such service should engage in that service alone, and devote their entire energies to that objective. Otherwise, the more lucrative return on investment which may be available outside of the transportation industry may serve to lure away the funds and the dedication of individuals to other more remunerative ventures, using carrier funds where available, to the detriment of the entire transportation industry's ability to provide service to the public.

SCOPE OF REVIEW

The primary emphasis of the review was on evaluating the effect of Punta's policies, procedures, and practices on

[1] Tax return prepared subsequent to current review of accounts.

the carrier as a transportation company, as manifested in the intercompany financial transactions.

Our review was conducted at the offices of the Bangor & Aroostook Railroad (carrier) and the Bangor Punta Corporation (Punta) at Bangor, Maine, on two separate occasions. Records reviewed included the accounting and financial records of Punta for the period October, 1964 through 1968, and the carrier's records for the period 1960 through 1969.

The holding company records maintained at Bangor, Maine, were made readily available for inspection during the initial review. When the final review was conducted, the holding company had disposed of its investment in the carrier; consequently, the holding company's records had been removed and were no longer accessible.

QUESTIONABLE PRACTICES
CORPORATE CHARGES

PROBLEM

Substantial sums of cash were transferred to the holding company as "corporate charges." These charges were not based on services performed, but upon the apparent requirements of the holding company in obtaining cash from the carrier.

RECOMMENDATIONS

That carriers be required to report contractual arrangements for management services entered into with affiliates, disclosing such details as types of services, basis of charges, and amounts charged carrier and other members of the group to the Commission for approval. Further, that Punta be required to reimburse the carrier $528,000 in corporate charges paid between October, 1964 and July, 1967.

DETAILS

Corporate charges were initiated by Bangor & Aroostook Corporation (B&A Corp.), the first holding company, for the purpose of providing cash with which to pay holding company expenses, such as legal, accounting, printing, salaries and wages, and travel. Allegedly these charges were allocated between companies. There was no adequate support for the amount allocated to the carrier. The carrier was notified of such assessment by one of its officials early in 1962 as follows:

> "It has been requested that Bangor and Aroostook RR be billed by B. A. C. for its share of services. For this year our share will be $105,400.00. Will you please accrue this monthly commencing with April 1962 at the rate of $11,711 per month. Charge to 551 (Miscellaneous Income Charges). You will be billed by B. A. C. quarterly with the first bill coming at the end of June."

In practice, the carrier used its cash to pay the holding company's bills. Amounts paid in this manner were applied against the corporate charges. During the period of ownership by B&A Corp., the carrier paid approximately $282,000 to satisfy the cash requirements of that holding company with no discernible benefit to the carrier.

Effective with the merger into Punta (October 1964), the carrier was required to pay Punta an arbitrary amount of $13,000 per month for the first 12 months, $16,000 per month for the second 12 months, and $20,000 per month for the final 9 months before such charges were discontinued. Cash payments totaling $528,000 were made to the holding company (Punta) between October, 1964 and June 1967.

Corporate charges or management fees totaled $810,000, including $282,000 paid to B&A Corp. (former holding company) and the $528,000 paid to Punta. These payments

were recorded in carrier's account 551, Miscellaneous Income Charges, indicating that it recognized these payments were not proper charges to transportation operating expense and not properly includible for rate case determination. Nevertheless the cash was paid by the carrier.

No specific details were available to support the amounts assessed. Carrier and holding company (Punta) officials described the payments as being for general management, such as legal and audit services. Punta's chief accounting officer stated that he had no knowledge of how the arbitrary charges were established or why such billings were discontinued.

The carrier received a separate bill from Peat, Marwick, Mitchell & Co., independent accountants, for audit services for the fiscal year ended September 30, 1967, in the amount of $9,714, which was $10,286 less than one month's assessment of $20,000. This indicates that the so-called corporate charges or management fees were far in excess of the amount needed to cover the cost of services provided.

Further, the carrier employs its own legal department and counsel. Therefore, with the possible exception of tax advice, the carrier had little or no need for legal services purportedly provided by holding company. Our investigation disclosed that the carrier was providing legal services to Punta.

Instructions to discontinue the charges were transmitted to the carrier's accounting department by President Strout in a memorandum dated August 8, 1967. No representative of the carrier has been able to support or demonstrate the services received for these expenditures.

SPECIAL CORPORATE CHARGES

PROBLEM

The carrier was required to pay the holding company an additional $158,794 in connection with a tax deficiency that resulted from an Internal Revenue Service (IRS) audit of consolidated federal income tax returns. Payment was passed on to the carrier despite the fact that only a portion of the tax deficiency assessment related to items pertaining to the carrier.

RECOMMENDATION

Require Punta to reimburse the carrier $63,535 for that portion which was not a liability of the carrier.

DETAILS

In August, 1967, $158,794 was paid to Punta through a transfer of cash from the carrier's account to the account of Bangor Punta Operations, Inc. (a 100% owned subsidiary of Punta), at the Franklin National Bank, New York, New York. This payment, charged to carrier's account 797, Retained Income - Appropriated, was based on the computation of a tax deficiency assessed against Punta after an IRS audit of the consolidated tax returns of the former Bangor & Aroostook Corporation for the years 1960 through 1963. The carrier and its subsidiaries participated in these consolidated returns along with other companies. In October, 1964, the assets and liabilities of B&A Corp. were merged into Bangor Punta Corp., and the B&A Corp. subsequently was liquidated.

The total deficiency assessment was $158,794.00 to which was added interest amounting to $53,161.47, making the total liability due the IRS $211,955.47. The controller of the carrier, explained that since the interest was a tax de-

ductible item, for the benefit of Punta, the carrier was not required to pay that amount to Punta. On a worksheet dated May 28, 1968, which he prepared, the deficiency was allocated as follows:

	Liability		
	Tax	Interest	Total
Carrier and subsidiaries	$ 46,421.00	$48,838.31	$ 95,259.31
Bangor Punta Operations	112,373.00	4,323.16	116,696.16
Total Assessment	$158,794.00	$53,161.47	$211,955.47

The interest expense of $48,838.31 allocated to the carrier, but not actually paid by it, seems disproportionate to the amount assigned to the holding company of $4,323.16. It was not possible to verify these figures as Punta had sold the carrier and the necessary records were not available to us. In connection with the deficiency tax assessment, the controller stated that the IRS required the carrier to capitalize for tax purposes certain items that the carrier had recorded in its operating expense accounts in accordance with the Commission's accounting rules.

However, this accounted for only a portion of the total tax deficiency; the remainder resulted from the disallowance of items attributable to other companies participating in the consolidated return. Punta, in allocating the deficiency, charged the entire amount to the carrier. To require the carrier to make full restitution to the holding company of the entire deficiency, when only a portion was attributable to the carrier is not just or reasonable. The controller indicated this on his worksheets when he referred to the difference between the amount the carrier paid of $158,794 and what he computed to be the carrier's liability of $95,259 as a "cash deficiency" of $63,535.

As pointed out above, the allocation of the total amount of the interest included in the assessment is also questionable. Consequently, any reduction of that figure would further reduce the carrier's total liability and at the same time it would increase the amount to be paid the carrier by Punta.

DIVIDEND PRACTICES

The staff encountered several problems in its analysis of dividends. These are shown below in two sections.

PROBLEM — A

Carrier's cash was transferred to B&A Corp. through a special dividend declared immediately prior to the merger of B&A Corp. into Punta. B&A Corp., as majority stockholder, received approximately 90% of the dividend.

DETAILS

On the effective date of merger with the Punta group, October 13, 1964, the railroad declared and paid a special cash dividend of $2.60 per share. The B&A Corp., owner of approximately 90% of the outstanding capital stock of the carrier, was the principal recipient. In the final liquidation of B&A Corp., cash in the amount of $336,978.75 was transferred to Punta. Thus, in the final analysis, Punta acquired most of the dividend through its control over B&A Corp. Therefore, Carrier's net worth was reduced to provide working capital to the holding company.

PROBLEM — B

Carrier assets were transferred to Punta through a dividend plan formulated by it to cancel certain of its debt obligations to the carrier.

RECOMMENDATION

That carriers involved in diversified holding companies be required to submit to this Commission for its approval details of all special dividends proposed to be paid, particularly when the holding company is the principal beneficiary.

DETAILS

In brief, the plan provided for the carrier to declare special dividends that would serve to improve the appearance of the holding company's balance sheet by eliminating debt due to the carrier.

Between December, 1960, and October, 1964, the carrier was owned by the Bangor & Aroostook Corporation (B&A Corp.). Effective October 13, 1964, the latter corporation was merged into Bangor Punta Corporation. Bangor Punta Operations, Inc., a subsidiary company, subsequently acquired ownership of the carrier in 1967. As a result of the merger, Punta assumed obligations of the B&A Corp., including interest bearing promissory notes due the carrier aggregating $602,000 and an interest bearing note in the amount of $585,700 payable to the Bangor Investment Co., a 100% owned affiliate of the carrier.

In July, 1966, Punta formulated a policy whereby the carrier would declare special dividends in addition to the regular dividend. Since Punta owned 98.9% of the carrier, the special dividends were not to be paid in cash, except to minority stockholders. Instead, Punta's share was to be paid "in kind," i.e., applied to reduce the note with the intention of eventually eliminating the debt entirely. The plan called for special dividends by carrier in each of the calendar years 1966, 1967, and 1968, in the per share amounts of $2.50, $2.50, and $1.70, respectively.

The 1966 special dividend reduced the holding company's debt to the carrier ($602,000.00) by $443,227.50, leaving a balance due of $158,772.50.

On January 27, 1967, Bangor Investment Co., declared a dividend of $585,700 to its parent, the carrier, giving it the note in amount of $585,700 due from Punta. Simultaneously, the carrier declared a special dividend of $2.50 of which $443,340 was applied to the note due from Punta, leaving a balance due of $142,360. In the final analysis, the two special carrier dividends reduced Punta's debt to the carrier from $1,187,700 to a balance of $301,132.50.

The planned special dividend program for the carrier was not completed as its earnings declined in 1968 because of a poor potato crop. Through the declaration of 1966 and 1967 special dividends, and poor earnings in 1968, retained income of carrier was reduced to an amount below which dividends could be paid under the restrictive provisions of carrier's mortgage. Because of these indenture dividend restrictions and continued low earnings no dividends were declared after 1967.

These dividend practices imposed on the carrier by Punta were planned to improve the balance sheet of the holding company and eliminate its interest payments to the carrier. As a result of this program, the carrier's net worth and income were reduced through transfer of assets to the holding company. Conversely, the holding company reduced its liabilities and interest expense and correspondingly increased its net worth, all to the detriment of the carrier.

MARKETABLE SECURITIES

PROBLEM

Marketable securities of a carrier subsidiary, Bangor Investment Co., were transferred to the holding company through a series of complex proceedings. The holding com-

pany acquired these securities with only a nominal outlay of cash, and subsequently realized substantial cash gains in the final liquidation for use in its expansion program.

RECOMMENDATION

That Commission approval be required for all such intercompany transactions to prevent the possible dissipation of assets by holding companies, and further that the carrier be required to make full disclosure of such transactions in its annual report to the Commission.

DETAILS

Prior to control of carrier by the B&A Corp., the Bangor Investment Company, a 100% owned subsidiary of the carrier, purchased St. Croix Paper Co. common stock as an investment at a cost of $2,127,000. The money to acquire the stock was borrowed from the carrier, except for $200,000 borrowed from the First National Bank of Boston and secured by 12,000 shares of the stock.

In December, 1960, B&A Corp. acquired ownership of the carrier and its subsidiaries. In September, 1962, the directors of the carrier approved the sale of the St. Croix stock to the holding company for a total of $2,127,000, the price paid on acquisition by the carrier's subsidiary. Payment was arranged as follows:

(a) B&A Corp. to assume the liability for the note payable to the First National Bank of Boston in the amount of $200,000.

(b) B&A Corp. to issue 15,000 shares of preferred stock, par value $100.00 per share, to be distributed; 10,180 shares to carrier and 4,820 shares to Bangor Investment Co.

(c) B&A Corp. to issue a new note to carrier in the amount of $427,000 bearing interest at 4½%.

The preferred stock and notes issued to the carrier represent replacement of notes totaling $1,445,000 payable to carrier by the Bangor Investment Co. In other words, Bangor Investment Company's liability to the carrier was transferred to B&A Corp.

Within four months after the B&A Corp. acquired the St. Croix stock, it was exchanged for 54,231 shares of Georgia Pacific stock, resulting in an increase of $585,700 in value. Since the St. Croix stock was disposed of in less than six months after acquisition by B&A Corp., B&A Corp. issued its promissory note in that amount to Bangor Investment Co. as per an agreement entered into at the time of the transfer. However, $443,340 of this amount was immediately returned to B&A Corp. in the form of dividends. This was previously commented on the section entitled Dividend Practices.

In 1964, the B&A Corp. reacquired its preferred stock by transferring ownership of 27,735 shares of the Georgia Pacific stock to the carrier at its market value, $1,554,114, representing an excess of $54,114 over the par value of the preferred stock reacquired. The carrier paid the B&A Corp. this difference of $54,114 in cash, and additional cash of $14,800 for 276 additional shares for a total of $68,914.

Of the total number of shares of Georgia Pacific stock acquired through the exchange, 54,231 shares, and through stock dividends, the B&A Corp. held 33,925 shares and the carrier 28,856 shares. B&A Corp. then sold to outside parties its remaining shares during the years 1963 and 1964, for $1,926,148.

To summarize the preceding details, the B&A Corp. required Bangor Investment Company to transfer its investment in the St. Croix stock to the holding company, and was able to acquire a substantial sum of cash. This also enabled

the holding company to realize a net profit of $782,362 within a two-year period from a cash investment of only $501,132.50. The balance of its investment cost was satisfied through paper transactions with the carrier and its subsidiary. B&A Corp., thereby, was supplied with cash to use in its diversification program.

The following schedule shows the various proceeds and gains to the holding company:

Cash Proceeds to B&A Corp. from sale of Georgia-Pacific stock:		
From sale to carrier		$ 68,914.00
From sale to others		1,926,148.00
Total Cash received		$1,995,062.00
Cost to B&A Corp.		
Cash cost:		
Bank note paid		$ 200,000.00
Cash paid carrier on notes issued		301,132.50
Noncash cost (notes issued and liquidated through paper transactions):		
Note #324 (to railroad)	$ 427,000.00	
Note #334 (to invest. co.)	585,700.00	
	$1,012,700.00	
Less cash paid to carrier (per above)	301,132.50	711,567.50
		$1,212,700.00
Gain on sale		$ 782,362.00

In addition to the above gain of $782,362, the holding company also received cash dividends from the ownership of the stock. The impact on the carrier of this transaction is that the carrier's affiliate lost the potential gain from the sale of securities that could have been realized had the assets been retained by the affiliate. Conversely, the holding company acquired substantial sums of cash through disposition of the stock for use in its expansion program. Consideration also should be given to the following:

(a) B&A Corp. had no cash at time of purchase and had to rely on future ability to pay the seller.

(b) Investment Co. had no need to dispose of the investment, i.e., it did not need cash.

FEDERAL INCOME TAXES

PROBLEM

The carrier contributed substantial benefits in the form of its operating losses and investment tax credits to the consolidated federal income tax return filed by the holding company. The carrier was not reimbursed for any of its contributions and further, these tax losses are not available to offset future taxable gains.

RECOMMENDATION

(a) Require carriers desiring to participate in consolidated tax returns to file with the Commission the basis and details of the method to be used in allocating the tax liability; and where such allocations are not in the public interest that the holding company be denied the inclusion of the carrier in its consolidated return.

(b) That the amount of tax benefits contributed by a carrier and its subsidiaries, and the policy regarding re-

imbursement, be disclosed in the annual report to this Commission.

DETAILS

Federal income taxes were computed on a separate return basis by the carrier and its subsidiaries, without benefit of operating loss carry-overs or investment credits. The results were submitted to Punta for inclusion in its consolidated return. Summarized below are the carrier's tax operating losses and investment credits which were made available to Punta for the consolidated return.

Year Ended Sept. 30	Taxable Income or Loss		Investment Tax Credit
	Carrier	Carrier & Subs	
1964			$ 280,509
1965	$ 457,806	$ 818,160	532,562
1966	(597,017)	(139,173)	496,025
1967	(1,200,631)	(1,147,289)	4,369
1968	(1,395,418)	(1,428,090)	253,322
1969	(1,486,218)	(1,496,133)	14,285
	($4,221,478)	($3,392,525)	$1,581,072

Carrier operating losses resulted largely from use of accelerated depreciation methods, previously adopted for tax purposes. Substantially all of the investment credits available to the holding company were contributed by the carrier. In evaluating the benefits, a rate of 48% was applied to the taxable losses of the railroad and its subsidiaries.

As a result of the tax practice imposed on the carrier, Punta received tax benefits totaling approximately $1.6 million from operating losses (48% of taxable losses of $3,392,525). Punta apparently was able to make full use of this benefit prior to sale of carrier, because it went into a tax paying position in 1968 and 1969. No provision was

made to reimburse the carrier for any portion of the amounts contributed by the carrier which are now not available to the carrier when it shows profit.

The total investment tax credit was used by Punta. There was no unused portion at date of sale (10/1/69).

Therefore, had the carrier not passed the operating losses on to its parent, the carrier would have been able to carry the losses forward to offset possible future profits. With no carry-overs left, future profit-making years will result in an immediate tax liability.

The holding company required the carrier to continue the accelerated depreciation method because if the carrier's interest had been considered, it would have initiated action to change over to a slower write-off, such as the straight-line method, to conserve these tax reductions to offset against profitable years of operation. The carrier had no tax liability of its own and carrier profits had declined; therefore, it would have been in the best interest of the carrier to defer the expense for future years, when conceivably it would be of more value to the carrier. The continued application of accelerated depreciation served the best interest of the holding company to the detriment of the carrier.

Loss carry-overs and other tax credits are valuable assets. Without the loss carry-overs, a tax liability will require the expenditure of carrier funds.

USE OF CARRIER'S CASH

PROBLEM

Punta imposed a restrictive policy on the use of the carrier's cash to satisfy Punta's corporate needs. This restriction prevented carrier from investing its excess cash and realizing income from such investments.

RECOMMENDATIONS

We recommend that Commission approval be required for any use or control of carrier's cash and that the holding company be required to demonstrate the benefits accruing to the carrier from such use. This requirement would prevent the holding company from imposing restrictive controls over the carrier's cash.

DETAILS

A loan agreement between Punta and its lending banks provided for compensating balances to be maintained. That agreement permitted Punta to take credit for carrier's cash balances. To satisfy the terms of the agreement, the carrier was required to maintain cash deposits larger than necessary to meet its own needs. When the average monthly deposits exceeded $1,344,000, carrier was paid interest at the rate of 3% per annum on the excess, a rate considerably below the prevailing interest yield. Perhaps more important, however, was the fact that the holding company exercised control over the carrier's cash at its own discretion, with no restrictions and with no concern about adequate compensation to the carrier.

CASH ADVANCES

PROBLEM

The carrier made frequent cash advances to satisfy the demands of Punta. Although compensated at prevailing interest rates, the carrier was required to keep cash readily available or borrow, if necessary. Controls of this nature could reduce the carrier's future borrowing capabilities, and impair its ability to maintain a viable transportation system.

RECOMMENDATIONS

That the indiscriminate use of carrier's funds be discouraged by requiring Commission approval for all advances made to the holding company or to other non-carrier companies in the group.

DETAILS

Advances and repayments are scheduled below in total by years. They were made at frequent intervals within each year.

Year	Total Advanced	Total Repayment
1965	$2,100,000.00	$1,700,000.00
1966	2,050,000.00	2,450,000.00
1967	800,000.00	800,000.00
1968	2,200,00.00	2,200,000.00
1969	— 0 —	301,132.00

With respect to the 1968 advances, it was necessary for the carrier to borrow $1,700,000.00 for which it received ¼ of 1% interest over that paid to the lending bank.

Although interest earnings on these advances were in accordance with prevailing rates, the advances restricted the carrier from using its funds in the development of its transportation properties, and further, restricted the carrier from investing its excess cash where it could provide a higher return from growth as well as through interest or dividends.

ACCOUNTING AND CLERICAL SERVICES PERFORMED FOR HOLDING COMPANY AND CARRIER'S SUPPORTING RECORDS

PROBLEM

During the period of ownership by B&A Corp., that holding company used carrier employees and office facilities to

perform its administrative functions, at carrier expense. To absorb the extra work, and minimize carrier expense, short-cut methods and procedures were adopted out of necessity. This resulted in voids in carrier's records of that period and seriously hampered the current review. The extent to which short-cut methods were used has placed carrier in violation of general instruction 1-3, Records, of the Commission's prescribed accounting regulations because entries are not supported by such detailed information as will permit ready identification, analysis and verification of all facts relevant thereto.

RECOMMENDATIONS

That all arrangements for management services, including use of carrier personnel and facilities, be covered by contractual arrangements requiring Commission approval; that the holding company demonstrate that the carrier will be adequately compensated for the use of its resources; and that these arrangements be fully disclosed in detail in annual reports to this Commission.

DETAILS

Carrier personnel were required to perform all clerical and accounting services for the B&A Corp. from 1960 until merger with Punta group in 1964. Being a small carrier, it normally maintains a relatively small office staff. The employee who prepared invoices for B&A Corp., or for the carrier, covering inter-company transactions, also was the same person who prepared vouchers or journal entries in settlement thereof. Consequently, only one set of documents was prepared to support inter-company transactions. In many instances, those documents were filed as holding company records. When the holding company files were turned

over to the Punta group, the carrier was left without adequate support for entries in its accounts. When Punta sold its interest in the carrier, access to any of Punta's records was entirely eliminated. For this reason, the carrier's records do not contain any support for entries made in connection with the so-called "corporate charges" referred to in another section of this report. (See Appendix VIII)

BONUSES — SALARY INCREASES OF CARRIER OFFICIALS

PROBLEM

Carrier officials were given bonuses, salary increases and promotions. Aside from the added expense to the carrier, the innovative and management capabilities of the executive officers were diverted from their prime business responsibility of operating the carrier to the expansion objectives of the holding company to the detriment of the carrier.

RECOMMENDATIONS

That where carrier officials are diverted from their primary responsibilities that Commission approval be required of such arrangements, fully disclosing all aspects of the arrangements such as the category of officials involved, their carrier responsibilities, the types of services which will be performed for the holding company, and the methods of allocating costs between the carrier and holding company.

DETAILS

We believe the management capabilities of key carrier officials were devoted primarily to the needs of the holding company. The following changes in compensation were made:

W. Jerome Strout. Prior to ownership by a holding company, he was Executive Vice-President of the carrier. During ownership by the B&A Corp. (12/1/60 to 10/13/64), he was elected a director of the B&A Corp. and President of the carrier. Coincidental with the merger with Punta (10/13/64), Mr. Strout was paid a bonus of $7,300.00. All other supervisory employees were given bonuses totaling $39,000.00. While the amounts do not appear large, this was a one-time bonus payment, substantial in relation to the size of the carrier and its regular policy regarding salaries and wages.

After the merger with Punta, Mr. Strout continued as President and Director of the carrier. Also, he was appointed Vice-President and Director of Punta. His entire salary, however, was paid by the carrier, and this was increased from $32,000.00 to $50,000.00 between July, 1964, and July, 1967.

W. Gordon Robertson. Mr. Robertson was principal officer of the carrier prior to ownership by a holding company, serving as President and Director. During the first two years of control by B&A Corp., Mr. Robertson served as President and Director of both carrier and B&A Corp. Obviously, he devoted a considerable portion of his time and attention to the vigorous task of expanding the holding company operations. In 1962 he gave up his position as President of the carrier, but continued to exercise control as Vice-Chairman and later Chairman of the Board of Directors of the carrier, while serving the holding company as President and Director and ultimately as Chairman of the Executive Committee and Chief Executive Officer.

Mr. Robertson's salary was increased significantly from $36,000.00 to $100,000.00 between July, 1964, and December, 1968. The carrier paid a portion of Mr. Robertson's salary;

whereas, no other company in the group made any direct contribution to the salaries of any holding company officials.

Mr. Robertson served the carrier as Chairman of the Board of Directors and as Chairman of the Executive Committee until shortly after Punta sold the carrier (10/1/69). As of October 28, 1969, he resigned his position as Chairman, but continued to serve the carrier as a member of the Board of Directors, and as a member of the Executive Committee.

Mr. John E. Hess. Mr. Hess was Vice-President of Finance and General Counsel of the carrier prior to the formation of the B&A Corp. When the first holding company (B&A Corp.) was created, Mr. Hess served both the carrier and the holding company in the same capacity. After the merger with Punta, Mr. Hess served the carrier as Vice President - Finance, and the holding company as Vice-President and Secretary. In 1966, he left the carrier and joined Punta as a full-time employee.

SALE OF THE RAILROAD

PROBLEM

As soon as the carrier's ability to contribute to Punta's profit objectives was impaired, and after eliminating most available working capital assets from the carrier, Punta disposed of its investment in the carrier, including its subsidiaries. Newspaper articles indicated the sale resulted in a substantial loss to Punta; however, the loss was primarily the result of an appraisal write-up of railroad properties which increased its investment.

RECOMMENDATION

To prevent this type of corporate manipulation of carriers wholly for financial interests we recommend that approval

of the Commission be required prior to acquisition of a carrier by a diversified holding company, and that specific benefits of the carrier's participation be demonstrated before approval is granted; and that the Commission reserve the authority to order divesture proceedings where such actions are not in the public interest.

DETAILS

Effective October 1, 1969, Punta disposed of its investment in the carrier and its subsidiaries. Punta's holdings in carrier stock, representing 98.2% of the capital stock outstanding, were sold in a cash transaction to Amoskeag Corporation, a Boston based investment firm, for $5 million, or about $28.00 per share.

The press releases announcing the sale refer to a book loss of about $13 million. We contend that Punta overstated its ownership of the carrier and in fact, including its transactions that caused carrier assets to be used or transferred, there was a net gain.

In determining the impact on Punta's investment in the carrier, we deducted from Punta's recorded investment in the carrier the amount of cash that flowed from the carrier to Punta through normal dividends, special dividends, corporate charges (management fees), and federal income tax benefits to show that the holding company in fact realized a substantial net gain.

After deducting the benefits to Punta from its investment of $4,785,993, as shown below, we arrived at an actual gain to Punta of $5,340,000, as follows:

Investment in 177,259 shares of carrier stock at $27 per share	$4,785,993
Less: Benefits to Punta:	
Corporate charges	528,000

Special charges	158,794
Dividends	1,311,441
Federal income tax contributions	1,628,412
Investment tax credits	1,500,000
	5,126,647
Net Investment	(340,654)
Proceeds from sale	5,000,000
ACTUAL GAIN	$5,340,654

Punta acquired ownership of carrier stock from the original individual stockholders through two tax-free stock exchanges not involving any cash consideration. In the first exchange, the carrier's stockholders received two shares of B&A Corp. common stock, a new issue, for each share of carrier stock. In the second exchange, the B&A Corp. stockholders received 1.1 share of Punta common and .4 of a share of Punta $1.25 Convertible Preference stock for each share of B&A Corp. common. In the latter exchange, Punta acquired the carrier and its subsidiaries plus four other companies owned by B&A Corp.

The cost or basis to be used as Punta's investment in capital stock of the carrier and its subsidiaries, therefore, was difficult to determine. The amount of $18,830,746.00 recorded on the books of the holding company as its investment in the carrier does not represent cost. (See Appendix VI) Instead, it represents B&A Corp.'s cost plus the net equity in undistributed pre-tax net income from December 1, 1960. It also includes a revaluation write-up exceeding $10 million. The net equity accounting[1] concept was started by the B&A Corp. and continued by Punta.

[1] Equity accounting permits the controlling company to record all the profits from its subsidiaries in its investment accounts when earned rather than when received as a dividend.

B&A Corp. recorded the investment in carrier stock at $27.00 per share, which was the reported sale price of the carrier's stock on the New York Stock Exchange on November 25, 1960, the latest sale prior to the effective date (November 20, 1960) of such exchange. The same price per share was used with respect to all carrier's shares subsequently exchanged for holding company stock, i.e., B&A Corp. and Punta. See Schedule of Investment in Carrier attached (Appendix VI) for a further analysis of the investment recorded on the holding company's books.

In determining Punta's cost, the market value of Punta's stock given in exchange was considered inappropriate because of the relationship of the number of shares previously outstanding to the number of shares given in exchange. On the other hand, if we were to use the market value of B&A Corp. stock as of the date of exchange (10/13/64), which was $28.00 per share, further consideration had to be given to B&A Corp.'s investments in the four other subsidiary companies along with the carrier. Those companies had made nominal contributions of dividend income, and except for Goal Credit Corporation, were profitable ventures. They were not sold with the carrier.

Punta's cost per share was deemed to be the per share value of $27.00, which was the value of carrier stock at the date of the first exchange in 1960, when B&A Corp. acquired the carrier. The total cost of $4,785,993 was arrived at by multiplying the number of railroad shares exchanged (177,259) times the value of $27.00 per share. In determining this cost, we eliminated net equity and the revaluation write-up of $10 million added by Punta in 1965, from the investment of $18,830,746 reflected in Punta's balance sheet at 9/30/69.

(d) For tax purposes, the selling price of $5 million represented a profit over the value of the carrier. The amount of profit is not yet known, but the tax base to Punta is the average of the bases to holders of carrier stock on the date they first exchanged their carrier stock for stock of the holding company (12/1/60), in a tax-free exchange.

The write-up by Punta in 1965 in the amount of $10,288,629 to a value of $18,384,808 was based on an appraisal by financial consulting firm of Hayden Stone, Inc., to show the "market value of the investment at September 30, 1965."[1] The contra credit to the holding company's books was to consolidated retained earnings.

POST SALE COMMENTS CONCERNING CARRIER'S ASSOCIATION WITH THE HOLDING COMPANY

The following comments or opinions were voiced by top management officials either in conversation or were included in corporate minutes or in a carrier publication directed to the carrier's employees. The excerpts are included as an expression of opinion and reflection of the views of responsible persons within the organization, two of whom also were principal general officers of the holding company. The intent here is to show that in retrospect carrier officials do not have a high regard for the results of the carrier's association with Punta, and that they look with favor upon the change in ownership.

BENEFITS TO THE RAIROAD

"The best thing that Punta did for us was to sell us to Amoskeag . . ." a quote from a conversation with a principal carrier official, when asked to comment on the benefits the railroad received from the holding company.

[1] Annual report to stockholders by Punta, p. 25.

EMPLOYEE MORALE

"Mr. Strout reported that the morale of supervisory employees had improved since the sale of the Company's stock from Punta to Amoskeag . . ." a quote taken from the minutes of a meeting of the Board of Directors of carrier held on January 23, 1970, after the carrier had been sold by Punta. "Mr. Strout" refers to carrier president W. Jerome Strout, who also was a Vice-President and Director of Punta.

WELFARE OF EMPLOYEES AND AREA SERVED

"A primary consideration in the sale was that Mr. Dumaine was a railroad man who would give due consideration to the welfare of the Company employees and the area served . . ." a quote also taken from the corporate minutes of January 23, 1970, by W. Gordon Robertson, former Chairman of the Board of the Carrier, and former principal executive officer of Punta. "Mr. Dumaine" refers to F. C. Dumaine, Jr., President of Amoskeag Company, a new owner of the railroad.

At the same meeting, Mr. Dumaine is quoted as saying, ". . . that he had no intention of stripping the railroad or turning its management over to any other company."

APPENDIX I

ORGANIZATION CHART
CORPORATE STRUCTURE

This attachment shows the corporate relationship of the carrier and those companies involved with ownership of the carrier.

These are presented as:

(A) *Carrier* prior to its formation of a holding company.

(B) After carrier created its internally generated holding company — *Bangor & Aroostook Corporation.*

(C) *Punta Alegre Sugar Corporation* prior to its takeover of the carrier's holding company (B & A Corp.).

(D) *Bangor Punta Corporation* at December 31, 1968 prior to its sale of the carrier at September 30, 1969.

A. *Bangor & Aroostook Railroad*
   1. Van Buren Bridge Co.
   2. Bangor Investment Co.
      (a) Machine Accounting, Inc.
      (b) McKay Rock Products Co.
      (c) Bangor & Aroostook Transportation Co. (Inactive)

B. *Bangor & Aroostook Corp.*
   1. Bangor & Aroostook Railroad
      (a) Van Buren Bridge Co.
      (b) Bangor Investment Co.
         (1) Machine Accounting, Inc.
         (2) McKay Rock Products, Inc.
         (3) Bangor & Aroostook Transportation Co. (Inactive)
   2. Goal Credit Corp. (May, 1961)

3. Bartlett-Snow-Pacific, Inc. (May, 1962)
4. Henry Luhrs Sea Skiffs, Inc. (May, 1962)
5. Bale Pin Co. (August, 1963)

C. *Punta Alegre Sugar Corp.*

1. Punta Alegre Commodities Corp.
   (a) C-G-F Topeka Grain Elevator
   (b) Pacific Metals Co., Ltd. (1962)
   (c) Crown Fabrics (1963)

D. *Bangor Punta Corporation* (December 31, 1968)

1. Bangor Punta Operations, Inc.

Divisions of B.P.O., Inc.

Bartlett-Snow, Cleveland, Ohio

Designs, engineers, fabricates and erects heat processing and bulk handling equipment for the chemical, process and foundry industries.

FECO, Cleveland, Ohio

Custom-engineered industrial ovens and furnaces, heat processing equipment, metal decorating ovens, sheet metal working machinery.

Young Brothers

Inactive

Tu-Bar

Inactive

The Barker Manufacturing Co., Tampa, Florida

Automatic materials — conveying equipment

Suchar, New York, New York

Buys and sells sugar processing equipment.

Jetstream Systems Company, Hayward, California

Custom-engineered processing and materials handling equipment, using controlled jets of air.

The Kinney Company, Providence, Rhode Island
Emblematic jewelry

The Luhres Company, Marlboro, New Jersey
Inboard wood and fiberglass power boats — wood luxury cruisers — fiberglass luxury cruisers.
Ulrichsen Company, Alura Division

Pameco-Aire, S. San Francisco, California
Wholesale distributor of refrigeration and air-conditioning equipment.

Clawgers Associates, Inc., Cherry Hill, N. J.
Printing

The O'Day Company, Fall River, Mass.
Non-auxiliary and auxiliary fiberglass sailboats.
O'Day (Canada) Limited
Canada Yacht and Boat Centre Ltd.

Jensen Marine, Costa Mesa, Calif.
Auxiliary fiberglass ocean-racing sailboats.

Seagoing Boats, Florence, Alabama
Steel and fiberglass houseboats.

Rent-A-Cruise of America, Florence, Alabama
Franchise: rental of houseboats.

Smith & Wesson, Springfield, Mass.
Top quality hand guns, handcuffs and related equipment.

Lake Erie Chemical Co., Rock Creek, Ohio
Tear gas munitions, riot control equipment.

Dominator Company, Kansas City, Missouri
Traffic control systems.

General Ordinance Equipment Corp., Pittsburgh, Pa.
Non-lethal weapons: Mace, etc.

Stephenson Company, Red Bank, New Jersey
Radar speed measuring devices, resuscitators, alcohol testing equipment, rescue and first aid equipment.

Smith & Wesson Leather Co., Monrovia, Calif.
Leather holsters, "Sam Brown Belts," etc.

Smith & Wesson Pyrotechnics, Inc., Jefferson, Ohio
Rocket flares, distress signals, related pyrotechnic devices, line throwing equipment.

Crown Fabrics, New York, New York
Converters and specialists in synthetic fiber technology. Styling, design and marketing of synthetic/natural fiber-blend fabrics.

Knitbrook Mills, New York, New York
Styles, manufactures and markets bonded knitted fabrics.

Knitbrook of Allentown, Pa.
Manufactures single-knitted fabrics primarily for Knitbrook.

Specialty Dyers, Concord, North Carolina
Piece goods dyers and finishers, primarily for Knitbrook.

Laminac, East Rutherford, N. J.
Bonding and laminating of knitted fabrics for Knitbrook and Crown.

Melena, East Rutherford, N. J.
Double knit fabrics of textured acetate and polyester, using jacquard and textured yarns, primarily for Crown.

Loombrook Mills, New York, New York
Inactive

Waukesha Motor Company, Waukesha, Wisconsin
High speed, industrial type, gasoline, diesel, and natural gas engines for farm tractors, fire trucks, lift trucks; laboratory fuel rating engines and total energy systems.

O. & M. Manufacturing Co., Houston, Texas
Radiators and heat exchangers.

Waukesha Alaska, Inc., Anchorage, Alaska
Factory-operated distributorship.

Waukesha Motor Western Limited, Waukesha, Wisconsin
Western hemisphere trading company.

Department:

Bangor Punta Management Services Co., New York, N. Y.
Management services for companies in which Bangor Punta has an equity interest.

Subsidiaries:

Bangor and Aroostook Railroad Company, Bangor, Maine (Sold 9/30/69)
All-freight railroad (wholly within the State of Maine)

Van Buren Bridge Co.
Switching company.

Bangor Investment Co.
Real Estate investments.

McKay Rock Products
Mining of stone, including ballast used by the railroad.

Machine Accounting, Inc.
Computer equipment for use of railroad and others.

Amco Liquidating Corp., Bangor, Mass.
Holding company (owner of 1/3 interest in a limited partnership).

BSP Corporation, San Francisco, Calif. (Sold 1969)
Sewage and waste disposal systems; multiple hearth furnaces, hydro-carbon heaters, thermal disc processors.

Bale Pin Company, Boston, Mass.
Emblematic jewelry; rings, pins and emblems for schools and clubs.

Starcraft, Goshen, Indiana
Aluminum, fiberglass outboard and inboard-outboard boats and sailboats; canoes, prams, campers, travel trailers, motor homes, farm equipment.

Duo Marine, Decatur, Indiana
Fiberglass and aluminum outboard and inboard-outboard runabouts.

Metcalf & Eddy, Inc., Boston, Mass.
International integrated civil and sanitary professional engineering firm, specializing in water supply, sewage treatment and refuse disposal.

Metcalf & Eddy, Ltd.

Metcalf & Eddy International, Inc.

Enesco, Inc., New York, New York
Acquisition services and financial planning for several client companies.

Bangor Punta International Capital Co., New York, N. Y.
International financing service.

Springfield Corp., Springfield, Mass.
Public service project involved the refurbishing of homes in Springfield through use of people considered unemployable.

Producers Cotton Oil Company, Fresno, California
Subsidiary of Bangor Punta Corporation. Commercial agriculture; integrated grower, processor, manufac-

turer and merchandiser. Cotton ginning and vegetable oil processing plants.

Prodco Warehouse Company
100% owned

Prodco Finance Company
100% owned

South Lake Farms
100% owned

Delta Cotton Company
50% owned

Santa Rita Ginning Co.
50% owned

Arizona Farming Company
Less than 50% owned

Painted Rock Ranches
Less than 50% owned

Producers Cotton Oil Company, or its wholly owned subsidiaries, also has an interest in numerous other subsidiaries or joint ventures.

APPENDIX II

HISTORY

Bangor Punta Corporation is a diversified holding company which acquired ownership of the Bangor and Aroostook Railroad in October, 1964, through merger of the Punta Alegre Sugar Corporation and Bangor & Aroostook Corporation. The latter company was formed in 1960 as a holding company for the purpose of acquiring the carrier and diversifying the business activities of that company. Corporate changes are summarized below:

Date — *Description*

Prior to 12/1/60

Bangor & Aroostook Railroad and its subsidiaries owned by individual stockholders.

12/1/60

Carrier and its subsidiaries acquired by Bangor & Aroostook Corp., in a tax-free exchange of stock.

12/1/60 - 10/13/64

Other Bangor & Aroostook Corp. acquisitions:

May 1961	Goal Credit Corp.
May 1962	Bartlett-Snow-Pacific, Inc.
May 1962	Henry Luhrs Sea Skiffs, Inc.
Aug. 1963	Bale Pin Co.

10/13/64

Bangor Punta Alegre Sugar Corp. created through merger of Bangor Aroostook Corp. and Punta Alegre Sugar Corp. Latter company included the following holdings:

Punta Alegre Commodities Corp.
C-G-F Topeka Grain Elevator
Pacific Metals Co. Ltd.
Crown Fabrics

10/1/67

Name changed from Bangor Punta Alegre Sugar Corp. to Bangor Punta Corporation. Also, Punta Alegre Commodities Corp. name changed to Bangor Punta Operations, Inc. Ownership of carrier and other acquired companies vested in Operations.

10/1/69

Effective date of sale of carrier and its subsidiaries to Amoskeag Company in a stock transaction.

Bangor and Aroostook Railroad is a relatively small, but important railroad serving the northern counties of the State of Maine. Connections to the south include Maine Central to Boston & Maine and Penn Central. Connections to the west include the Canadian National and Canadian Pacific, or Maine Central to Boston & Maine to Delaware and Hudson, etc.

Historically it has been a well managed and profitable enterprise. In recent years, however, profits have declined sharply, due in part to changes in potato traffic. Diversion of potato traffic to trucks is described as resulting from the "deterioration of railroad service" of the major Eastern trunk lines.[1] Some loss of revenue also resulted from marketing changes, i.e., from fresh to processed product.

The carrier maintains general offices at Bangor, Maine. Railway operating revenue and net income for 1969 were $13.4 million and $108 thousand, respectively.

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[1] Maine Department of Agriculture (MDA Report 69-01, October, 1969, Marketing Fresh Maine Potatoes: Problems in Transportation, page 4).

Boston Herald 10-3-69

AMOSKEAG CO. TO PURCHASE MAINE RAIL LINE

BANGOR, Me. (AP)—Amoskeag Co. has signed an agreement to purchase control of the Bangor & Aroostook Railroad from Bangor Punta Corp. for $5 million, the two parties announced yesterday.

In announcing the transaction, the firms said the sale will result in "a non-recurring book loss of approximately $13 million with no tax benefit to Bangor Punta Corp."

The freight carrier's stock is carried on Bangor Punta's books at approximately $18 million.

The railroad said Bangor Punta will receive no tax benefit from the loss and part of the $5 million purchase price will be subject to capital gains tax.

F. C. Dumaine Jr., president of Amoskeag, said he contemplates no changes in railroad operation or management. W. Jerome Strout of Bangor will remain president and chief executive of the railroad.

The 78-year-old railroad serves agricultural and forest interests in northern Maine. Since the 1964 merger of Punta Alegre Sugar Corp. with Bangor & Aroostook Corp. it has been a subsidiary of Bangor Punta.

Bangor Punta is a diversified manufacturing company with holdings in the public security, leisure time, energy and textile fields.

Amoskeag is a Boston-based holding company.

APPENDIX IV

AMOSKEAG COMPANY

Amoskeag Company is a Boston based investment firm, whose president, F. C. Dumaine, Jr., and family have long been associated with the railroad industry. Dumaine formerly was president of the New York, New Haven and Hartford, and the Delaware and Hudson Railroads.

Amoskeag's investments also include 26.15% stock ownership of the *Maine Central Railroad.* This stock was placed in trust with the Irving Trust Co., New York, prior to Amoskeag's purchase of the Bangor and Aroostook Railroad.

Amoskeag's principal investments, listed in Standard and Poor as of April, 1969 under subsidiaries and affiliated companies include the following:

Champlain National Co.
Computek, Inc.
Intercomputer Corp.
Fanny Farmer Candy, Inc.
Fieldcrest Mills, Inc.
Maine Central Railroad
Springfield Street Railway
Worcester Bus Co.
Westville Homes Corp.

A variety of other investments listed include holdings in nationally recognized companies, but none are substantial enough for the companies to be classified as subsidiaries or affiliates.

APPENDIX V

NICOLAS M. SALGO

Nicolas M. Salgo (Salgo) was the strong personality providing the drive behind the carrier's formation of a holding company and its later involvement with a diversified holding company, with himself emerging as the top official of the company.

Salgo was presented to the Carrier's Board of Directors at a meeting held March 1, 1960, as the person qualified to carry out its diversification program, which was approved by the directors at that same meeting. At March 25, 1960, the carrier entered into a formal employment contract with Salgo which provided that he was:

> "to suggest and develop an overall program for diversification of business activities of the Company, to explore specific avenues of diversification, to carry approved projects through to execution, and to perform such other similar duties as may from time to time be required by the Board or by the President."

The agreement provided for employment for a period of not less than 10 years, and for his services he was to receive annual compensation of $12,000.00. Further, the directors granted Salgo an irrevocable option to purchase up to 20,000 shares of its common stock at $26.50 per share.

In 1960, almost immediately after the contract was consummated, Bangor & Aroostook Corp. (B & A Corp.) was formed and acquired ownership of the carrier, upon the advice of Salgo. B & A Corp., the newly created holding company, took over Salgo's employment contract. With respect to the stock option plan, the number of shares granted was increased to 40,000 at $13.25 to conform to the

exchange ratio of two shares of holding company stock for one share of carrier stock.

The first company acquired by the B & A Corp. (after the carrier) was Goal Credit Corp., a commercial loan company in which Salgo and members of his family held about a 30% interest. Acquired in 1961, Goal Credit Corp. subsequently suffered substantial losses on outstanding loans and was sold as of July 31, 1966, at approximately book value.

As Director of Corporate Expansion, Salgo arranged for B & A Corp. to acquire four companies,[1] including Goal Credit Corp. The carrier, however, provided the backbone of the B & A Corp.

In 1964, Salgo arranged for the B & A Corp. to merge with *Punta Alegre Sugar Corp.*, a holding company with an operating company and three other subsidiaries. Salgo was Director of Corporate Expansion for B & A Corp. and Chairman of the Board of Punta at the time of merger.

As a result of Cuban assets having been seized by the Castro regime, Punta had a foreign expropriation loss of about $20 million, which Punta elected to carry forward on its federal income tax return for a period of ten years, of which approximately $16.5 million was unused. Consequently, Punta incurred no federal income tax liability until 1968.

Through Punta, Salgo achieved some degree of success in his ventures, making full use of carrier assets and the talent of carrier mangement. As a result, Bangor Punta Corp. was held out by many advocates of carrier diversification as a shining example of what a holding company, through diversification, could do for a carrier.

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[1] See Appendix I for details of corporate structure which show affiliated companies.

The carrier furnished management as well as funds for achieving success in Punta's expansion program; however, our review disclosed that the carrier received no benefits in return. When the carrier became weakened through operating difficulties, Punta failed to render the assistance allegedly offered as the benefits for participation in diversified holding company relationships.

APPENDIX VI

INVESTMENT IN CAPITAL STOCK BANGOR & AROOSTOOK RAILROAD PER BOOKS OF ACCOUNT AND REPORTS TO STOCKHOLDERS

Bangor & Aroostook Corporation

Investment in carrier stock:		
12/1/60	162,561 shares @ $27.00	$4,389,147
Additional — at various dates	14,019 shares @ $27.00	378,513
		$4,767,660
Add: Net equity in undistributed pre-tax net income of carrier and its subsidiaries, 1961-1964		1,939,676
Investment 9/30/64, per 1964 Annual Report to shareholders		$6,707,336

Bangor Punta Corp.

10/13/64	Investment balance brought forward from B & A Corp. books, per above	$6,707,336
Add:	Investment in additional carrier stock exchanged for Punta shares—679 shares @ $27.00 per share	18,333
	Net equity in undistributed pre-tax net income of carrier and its subsidiaries, 1965-1967	1,496,650
	Credit from revaluation of investment by Hayden Stone, Inc., recorded as a credit to consolidated retained earnings[1]	10,288,629

[1] This is merely a write-up of its investment, and consideration must be given to this $10 million write-up in any publicly announced losses suffered by Punta in its ownership of the carrier.

Adjustment of investment balance on reports to shareholders 1964-1965 to reflect balance of $18,384,808 per appraisal report	319,798
Investment 9/30/68, per 1968 Annual Report to Shareholders	$18,830,746

APPENDIX VII

SCHEDULE OF OFFICERS AND DIRECTORS

A. *Bangor & Aroostook Railroad* — December 31, 1960
At date of acquisition by B & A Corp.

Officers

E. D. Van Loben Sels, Chairman
W. G. Robertson, President
W. J. Strout, Exec. V.P.
Carl R. Smith, V.P.
H. L. Cousins, V.P. Mktng.
John E. Hess, V.P.—Finance—Gen. Counsel
C. C. Morris, Treas.
C. E. Delano, Personnel Director

Directors

Edwin E. Parkhurst
W. J. Strout
Geo. H. Seal
W. G. Robertson
F. L. Putnam
T. E. Houghton
H. E. Umphrey
Arthur J. Pierce
D. D. Daigle
E. D. Van Loben Sels
A. J. April
L. F. Parent
W. B. Snow

B. *Bangor & Aroostook Corp.* — December 31, 1963

Officers

E. D. Van Loben Sels, Chmn.
W. G. Robertson, Pres.

J. E. Hess, V.P. — Gen. Coun. Clerk
R. D. Plumley, Treas.
N. M. Salgo, Dir. of Corp. Exp.
R. H. Peters, Asst. to Pres.

Directors

E. P. Van Loben Sels
W. G. Robertson
H. E. Umphrey
A. J. April
G. H. Seal
W. E. Hill
F. M. Rodenberger
H. C. Wood
W. J. Strout
R. L. Chambers
F. Chorin

C. *Punta Alegre Sugar Corp. 9/30/63*
Prior to merger with B & A Corp.

(x) N. M. Salgo, Chmn. & Chief Exec. Officer
R. L. Chambers, Pres.
T. D. Stephenson, V.P. Sec. & Treas.
R. J. Gilmartin, Asst. Sec.
Stephen Galle, Asst. Sec.
R. S. Burnham, Asst. Sec.

Directors

W. H. Schaum
W. C. Douglas
G. S. Jones
F. H. Kingsbury, Jr.
J. G. Tremaine
R. G. Stone
N. M. Salgo

W. B. McKinney
R. L. Chambers
(x) W. G. Robertson
(x) Neither Salgo nor Robertson were listed as an officer or director as of 9/30/60. Salgo was employed by carrier as of 3/25/60.

D. *Bangor Punta Corp.* 9/30/69
Date carrier was sold

Officers
N. M. Salgo, Chairman of the Board
W. G. Roberston, Chief Exec. Officer
Chmn. of Executive Comm.
D. W. Wallace, Pres. & Chief Operations Officer
Stephen Galle, Senior V.P.
J. E. Flick, Senior V.P. — Gen. Counsel — Sec.
T. D. Stephenson, Adm. V.P. & Treas.
C. E. Delano, V.P. — Personnel
D. C. Morrill, V.P. — Corp. Relations
M. F. Wray, V.P. — Acquisitions — Mergers
Harold Ehrenstrom, V.P.
D. C. Phillips, V.P.
J. L. Oberg, V.P.

Directors
William E. Hill
W. C. Douglas
G. S. Jones
F. H. Kingsbury, Jr.
J. G. Tremaine
R. G. Stone
N. M. Salgo
W. B. McKinney
W. G. Robertson

C. M. Hutchins
H. S. Baker
S. K. Lowry
George H. Seal
H. C. Wood
J. E. Flick
R. A. Page
C. E. Nelson
D. W. Wallace

E. *Amoskeag Co.* 9/30/69
Date acquired carrier

Officers
W. B. Snow, Chmn. of Board
F. C. Dumaine, Jr., Pres.
D. B. Dumaine, V.P.
H. T. Wiggin, Treas.
T. H. Casey, Controller
F. P. Melzar, Sec.

Directors
F. J. Sulloway
A. B. Hunt, Jr.
F. C. Dumaine, Jr.
A. B. Hunt
W. B. Snow
Ralph Lowell
J. I. Ahern
H. E. Melzar
H. M. Cole

F. *Bangor & Aroostook Railroad* 12/31/69
After sale to Amoskeag

Officers
W. J. Strout, President

W. M. Houston, V.P. — Gen. Counsel
Donald B. Annis, Treas.
Owen J. Gould, Controller

Directors

William E. Hill
Joseph R. Lapointe
George H. Seal
Richard K. Warren
H. C. Wood
T. E. Houghton, Jr.
J. R. McPike
Wendell L. Phillips
W. G. Robertson
D. D. Daigle
Dudley B. Dumaine — 10/28/69
F. C. Dumaine, Jr. — 10/28/69
Roger B. Prescott, Jr. — 10/28/69
Fred L. Putnam
Jack Roth
W. J. Strout

APPENDIX VIII

SCHEDULE OF CASH BENEFITS TO HOLDING COMPANY

Description	Received by B&A Corp.	Received by Punta
Corporate Charges or Management Fees	$ 282,479	$ 528,000
Special Corporate Charge		158,794[1]
Gain on Marketable Securities	782,362	
Dividends:		
Regular		424,874
Special	459,108	886,567[2]
Federal Income Tax Benefits:		
From Operating Losses		1,628,412[3]
From Investment Tax Credits		1,566,787
Totals	$1,523,949	$5,193,434

[1] *Recommended Recovery*

Tax Deficiency		
Attributable to carrier and its subsidiaries	$ 46,421	
Attributable to others	112,373	$158,794
Chargeable to Carrier		
Carrier portion of tax deficiency	46,421	
Interest assessed	48,838	95,259
Refund due carrier		$ 63,535

[2] To liquidate debt.

[3] 48% of net operating losses contributed to Punta's consolidated tax return.

APPENDIX C

SUMMARY OF ARGUMENTS MADE BY THE RAILROAD IN THE COURT OF APPEALS BUT NOT PASSED UPON BELOW

1. Equitable Defenses May Not Bar Claims Based on the Federal Antitrust Laws

Federal law controls what defenses are available against claims based on federal law. *Dice* v. *Akron, C. & Y. R.R.*, 342 U.S. 359, 361 (1952), *Isidor Weinstein Investment Co.* v. *Hearst Corporation*, 303 F.Supp. 646, 649 (N.D.Calif. 1969) Common law barriers should not be applied. *Perma Life Mufflers* v. *International Parts*, 392 U.S. 134, 138-9 (1968) The unclean hands defense has been repeatedly rejected, because of the public policy of deterring antitrust violations. *Magna Pictures Corp.* v. *Paramount Pictures Corp.*, 265 F.Supp. 144, 149 (C.D.Calif. 1967), *Waldron* v. *British Petroleum Co.*, 231 F.Supp. 72, 92 (S.D.N.Y. 1964), *Trebuhs Realty Co.* v. *News Syndicate Co.*, 107 F.Supp. 595, 599 (S.D.N.Y. 1952) This public policy of deterrence indicates that an innocent party plaintiff should not be barred by a defense of unjust enrichment, particularly where the innocent party plaintiff is a railroad bringing suit under §10 of the Clayton Act against a former controlling stockholder.

2. Equitable Defenses May Not Bar Claims Based on the Federal Securities Laws

Federal law governs the extent of the remedies available under the federal securities laws. *J. I. Case Company* v.

Borak, 377 U.S. 426, 433 (1964), *Clement A. Evans & Co.* v. *McAlpine,* 434 F.2d 100 (CA5 1970), cert. denied 402 U.S. 988, rehearing denied 404 U.S. 874, *Kohler* v. *Kohler Co.,* 319 F.2d 634, 642 (CA7 1963) The "unclean hands" defense is not available in securities actions because of the public policy of deterring violations. *Nathanson* v. *Weis, Voisin, Cannon, Inc.,* 325 F.Supp. 50 (S.D.N.Y. 1971), *Pearlstein* v. *Scudder & German,* 429 F.2d 1136, 1141 (CA2 1970), cert. denied 401 U.S. 1013, *Hooper* v. *Mountain States Securities Corporation,* 282 F.2d 195 (CA5 1960), cert. denied 365 U.S. 814. This public policy of deterrence indicates that an innocent party plaintiff should not be barred by a defense of unjust enrichment. *Janigan* v. *Taylor,* 344 F.2d 781, 786 CA1 1965), cert. denied 382 U.S. 879, cited with approval in *Affiliated Ute Citizens* v. *U.S.,* 406 U.S. 128, 155 (1972).